Supreme Court, U. S.
FILED
MAR 9 1972
JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No. 71- 71 - 1152

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

vs.

RONALD F. DWYER, Director of Property Valuation of The State of Kansas, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No. 71-

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

vs.

RONALD F. DWYER, Director of Property Valuation of The State of Kansas, et al.,
*Respondents.**

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

Petitioner Panhandle Eastern Pipe Line Company respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of the State of Kansas entered in this proceeding on May 15, 1971, and the opinion on rehearing entered by that court on December 11, 1971.

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*Other respondents are The State Board of Tax Appeals of Kansas and The State Board of Equalization of Kansas, and Charles Joseph, Ralph McCarty, Eugene E. Lee, and William D. Anderson, Jr., the members of The State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas, and John E. Royston, attorney for and secretary of said Boards.

OPINIONS BELOW

The initial opinion of the Kansas Supreme Court (Appendix A, p. A1 et seq.[1]) is reported at 207 Kan. 417 and 485 P.2d 149. The opinion on rehearing by the Kansas Supreme Court (Appendix C, p. A19) is reported at 208 Kan. 304 and 491 P.2d 961. The opinion of the Kansas Supreme Court in *Northern Natural Gas Company* v. *Dwyer* (Appendix D, p. A25 et seq.) is reported at 208 Kan. 337 and 492 P.2d 147; Chief Justice Fatzer incorporated his dissenting opinion in that case in his dissenting opinion in the opinion on rehearing in this case.[2] The memorandum decision of the District Court of Johnson County, Kansas (Appendix G, p. A104 et seq.) is not reported.

JURISDICTION

The judgment of the Kansas Supreme Court was entered on May 15, 1971. A timely motion for rehearing was granted by an order (Appendix B, p. A18) entered on June 16, 1971. The opinion on rehearing was entered on December 11, 1971, and this petition for certiorari was filed within 90 days from that date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1257(3).

QUESTIONS PRESENTED

1. Whether the grossly excessive valuation for ad valorem tax purposes of that portion of Petitioner's interstate natural gas pipeline system which is located in Kansas contravenes Petitioner's rights under the Fourteenth Amendment?

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1. The appendices are separately presented; appendix page references are to that volume.

2. Applications for review by this Court have been filed in *Northern Natural Gas Company* v. *Williams, et al.*, *Northern Natural Gas Company* v. *Dwyer, et al.*, and *Northern Natural Gas Company* v. *Bender, et al.*, Nos. 71-1104 and 71-1105, all of which involve issues substantially similar to the issues here involved.

2. Whether the separate classification of the pipeline systems of Petitioner and other natural gas pipeline companies and the application of an assessment ratio to such separately classified property which is substantially in excess of that applied to the mass of property in the state contravenes Petitioner's rights under the Fourteenth Amendment?

3. Whether a state's discrimination against Petitioner and others operating regulated interstate natural gas pipeline systems in apportioning the state's total property tax burden, so that such interstate pipeline systems bear more than their fair share of such tax burden, constitutes an illegitimate restraint on interstate commerce in contravention of the Commerce Clause?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Constitution of the United States, Article I, Section 8, Clause 3.

Constitution of the United States, Fourteenth Amendment.

Constitution of the State of Kansas, Article 11, Section 1.

Sections 2, 5, and 9 of the Natural Gas Act, 52 Stat. 821, 822, 823, and 826, as amended, 15 U.S.C. §§717(a), (d) and (h).

Kansas Statutes Annotated (Official):

K.S.A. 1969 Supp. 74-2426.

K.S.A. 79-501.

K.S.A. 1968 Supp. 79-503.

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K.S.A. 79-1437.
K.S.A. 1968 Supp. 79-1441(a).
K.S.A. 1968 Supp. 79-1443.

The pertinent text of the foregoing is set forth in Appendix H.

STATEMENT OF THE CASE

Petitioner owns and operates an interstate natural gas pipeline system. Its principal business is the transportation of natural gas for sale both to local distributing companies for resale for ultimate public consumption and directly to industries and to others for their own use. As such, it is a "natural gas company" within the meaning of the Natural Gas Act. 52 Stat. 821, 15 U.S.C. Section 717 et seq. A portion of Petitioner's system, including pipelines, compressor stations and related facilities, is located within the State of Kansas and such property is assessable within that State for ad valorem tax purposes. This case involves a difference of $60,000,000 in the value of the Kansas portion of Petitioner's system for such purposes and an annual additional tax impact on Petitioner of some $1,500,000.

The first step in determining the assessable value of that portion of Petitioner's system which is within Kansas is a determination of the "justifiable value" (K.S.A. 79-501) for Petitioner's entire system, which is located in a total of eight states.[3] For the year in question, an agreed 29.47% of that amount was allocable to Kansas as representing the portion of the total system which was located

3. "Justifiable value" basically equates with "fair market value". *Board of County Com'rs of Shawnee Co.* v. *Brookover*, 198 Kan. 70, 422 P.2d 906 (S. Ct. Kan. 1967); *cf.*, K.S.A. 79-501, as amended, L. 1969, Ch. 433, §2, effective July 1, 1969.

and taxable within Kansas. An assessment percentage is then applied to that allocable amount to determine the total assessable value of the Kansas portion of the system. The resulting amount is then apportioned among the twenty-six Kansas counties in which Petitioner's property is located so that the tax owing to each county can be computed on the basis of the local tax rates.

The parties are basically in agreement as to the procedures to be followed; their primary differences relate to (1) the value of Petitioner's entire system, to which the agreed 29.47% allocation factor is applied and (2) the assessment percentage or percentages to be applied to the resulting Kansas value for purposes of determining assessed value. The evidence relevant to a consideration of these issues will be set forth in context in the discussion of the reasons for granting the writ.

For the year 1969, Petitioner returned $30,967,805 as the equalized assessed value of the portion of its interstate pipeline system within Kansas. Thereafter, the respondent Dwyer, as Director of Property Valuation (hereafter "Director"), issued his order (Appendix E, p. A100) fixing Petitioner's assessed valuation at $56,078,497. The Director arrived at this figure by first determining that the justifiable or market value of that portion of the pipeline system within Kansas was $186,928,324, the exact original undepreciated cost of the property to the dollar and then applying the statutory 30% assessment ratio to that amount. Petitioner disagreed with the Director's use of undepreciated original cost as the determinant of the current market value of the portion of the system in Kansas and with the 30% assessment ratio applied thereto.

Petitioner appealed the Director's order to the State Board of Tax Appeals and State Board of Equalization (a

single state agency hereinafter referred to collectively as the "Board"). Despite the presentation by Petitioner of extensive evidence both as to (1) the market value of the interstate pipeline system and the portion thereof in Kansas and (2) as to the level or ratio of assessment in Kansas generally and in each Kansas county traversed by the pipeline system, the Board affirmed the Director's action, thereby denying relief to Petitioner (Appendix F, p. A101). Petitioner appealed the Board's order to the District Court of Johnson County, Kansas, in which is located some of the property involved. In due course, the District Court entered its decision and judgment (Appendix G, p. A104) affirming the Board's order. On appeal, the Kansas Supreme Court affirmed, with three of seven justices dissenting (Appendix A, p. A1 et seq.), but thereafter granted Petitioner's motion for rehearing. Consideration on rehearing was in conjunction with consideration of *Northern Natural Gas Company* v. *Dwyer* (Appendix D, p. A25 et seq.), which involves the same basic issues. The Kansas Supreme Court reaffirmed on rehearing, with two justices dissenting, one justice concurring specially, and one justice not participating (Appendix C, p. A19 et seq.).

PRESENTATION OF FEDERAL QUESTIONS

The basic issues of this case are constitutional in nature and Petitioner has presented these issues in the necessary factual context throughout these proceedings. Thus, in Paragraph 7 of its Appeal to the Board from the Director's Order, Petitioner asserted that the Director's action "constitutes deprivation of property without due process of law and denial of equal protection of the law contrary to the Fourteenth Amendment of the Federal

Constitution." (R. 16).[4] The Board did not pass upon these questions.

In Paragraph 8(o) of the Notice of Appeal from the Board's Order to the District Court of Johnson County, Kansas, Petitioner contended that the Board's action placed a higher valuation and assessment on its property and that of other interstate utilities than upon local real estate, and "constitutes an unreasonable burden upon interstate commerce in violation of the Commerce Clause, Article I, Section 8, of the United States Constitution, and deprives Appellant of its property without due process of law under the Fourteenth Amendment of the United States Constitution, and is an unlawful classification of property for valuation and assessment for ad valorem tax purposes under Article 11, Section 1 of the Kansas Constitution" (R. 9). Similar contentions were also asserted in Paragraphs 8(d), (m), (q) and (u) of said Notice of Appeal (R. 5, 8 and 10). The District Court indirectly acknowledged the presence of constitutional questions in the case (R. 184) but did not deal directly with the requirements of the Kansas and United States Constitutions nor pass on the questions specifically raised by Petitioner.

In Paragraph 7 of its statement of points on appeal to the Supreme Court of Kansas, Petitioner summarized the federal questions involved as follows: "The judgment of the trial court deprives Appellant of its property without due process of law and denies it the equal protection of the law under the Fourteenth Amendment to the Constitution of the United States and constitutes an unreasonable burden upon interstate commerce in violation of the Commerce Clause, Article I, Section 8, of the

4. Record references are to the Record on Appeal before the Kansas Supreme Court, which is a part of the certified record before this Court.

Constitution of the United States." (R. 199). The Kansas Supreme Court failed to rule expressly on these questions either in the initial opinion or the opinion on rehearing.

REASONS FOR GRANTING THE WRIT

1. Grossly Excessive Valuation of Petitioner's Interstate Natural Gas Pipeline System Through the Disregard by Kansas Taxing Officials of Kansas Constitutional and Legislative Requirements Constitutes a Denial of the Due Process and Equal Protection of the Law Guaranteed by the Constitution of the United States.

The simple truth of this case is that the Kansas taxing officials have wholly failed to comply with the Kansas Constitution and the Kansas statutes which direct the manner in which Petitioner's property is to be assessed for ad valorem tax purposes within that state. The federal constitutional questions involved herein arise as a direct result.

As has been indicated, the beginning point in this regard is a determination of the "justifiable value" (or fair market value) of Petitioner's assessable property within Kansas. K.S.A. 79-501. The Kansas statutes specify a number of factors which are to be considered in determining justifiable value and the Kansas Supreme Court has held that all such factors which are pertinent must be applied in making that determination. *Garvey Grain, Inc.* v. *MacDonald,* 203 Kan. 1, 453 P.2d 59 (1969). Among the statutory factors which are pertinent to a determination of the value of Petitioner's property are depreciation, including physical deterioration or functional, economic or social obsolescence; cost of reproduction; productivity; earning capacity as indicated by capitalization of net income; and other elements which could reasonably affect that valuation. K.S.A. 1968 Supp. 79-503 ("K.S.A.

79-503"). Original cost is not one of the factors specified by K.S.A. 79-503.

The Director did not in fact give any bona fide consideration to any of the statutory factors prior to determining a value for Petitioner's property. Instead, the evidence shows beyond question that the Director simply determined that the value of Petitioner's property in Kansas for 1969 was its original undepreciated cost and that its assessed value was 30% of that figure. Thus, as is shown on State's Exhibit E (R. 379), the $56,078,497 assessed value determined by the Director is 30% of Petitioner's total Kansas original cost to the very dollar. Furthermore, as was noted by Chief Justice Fatzer in his dissent in the companion case of *Northern Natural Gas Company* v. *Dwyer*, the Director's appraiser, who actually made the appraisals involved in both that case and this, testified that "I am stating under oath that I was directed to predetermine a value of original cost and then work toward that value" (Appendix D, at page A94).

It is fundamental under K.S.A. 79-503 that no single factor is conclusive in establishing justifiable value in any event. *Garvey Grain, supra.* Furthermore, undepreciated original cost is generally not even a persuasive consideration in determining current value, which can be no better illustrated than by this case. Petitioner's interstate pipeline system was initiated in 1931 when a single large diameter pipeline was completed across Kansas. That line is still in existence and use. Petitioner's system has been expanded from time to time by the installation of additional pipelines and related facilities. It hardly warrants stating that the cumulative original cost of these facilities is no measure whatsoever of their fair market value today.

One of the statutory factors required to be considered in determining the value of Petitioner's property was "earning capacity as indicated by . . . capitalization of net income". K.S.A. 79-503(g). In his machinations to retroactively justify his determination of value, the Director contended that a 5% income capitalization rate should be used for purposes of applying this factor. A low capitalization rate, of course, produces a higher indicated value. The Kansas Supreme Court seized upon the value indicated by the Director's computation in regard to this factor as justification for the acts below and effectively decided the appeal when it held (Appendix A, p. A11):

> "If the Board was not guilty of unreasonable, arbitrary or capricious conduct in using the 5% figure for capitalizing income this court should not interfere with the assessment order."

The egregious error committed by the Kansas Supreme Court is sharply illustrated by the foregoing holding. To begin with, the court below ignored the indisputable fact that income capitalization played no actual part in the Director's determination of justifiable value. Then the court held in effect that income capitalization is the exclusive factor to be used in valuing Petitioner's property, a holding clearly contrary to K.S.A. 79-503. Finally, the opinion ignored the fact that the Director's appraiser who made the 5% income capitalization rate computation testified on cross-examination that no reasonable investor would have accepted less than 7-1/2% at the relevant time, an admission which rendered meaningless the use of the artificially low 5% rate (R. 52, 53).

It is interesting to note that a higher income capitalization rate, 7%, was agreed to by the expert who testified on behalf of Petitioner and who pointed out that a 5%

rate would not even service Petitioner's long term debt (R. 104-5, 124). This is a critical consideration, since even two percentage point change in assumed capitalization rate produces a 40% difference in indicated value and a two and one-half percentage point change produces a 50% difference in indicated value. Petitioner's expert, who appraised Petitioner's entire system and who testified that he considered all relevant factors required by K.S.A. 79-503, arrived at a system value of $437,500,000 and a Kansas value of $128,931,250 (R. 246 et seq.).

Earning capacity is, of course, a most important consideration in determining value and the best evidence of that capacity, as was also duly noted by Petitioner's expert, is the basis upon which Petitioner actually earns (R. 92-93, 264). As an interstate natural gas transmission company, regulated by the Federal Power Commission (FPC), Petitioner, in brief, is only permitted to earn at a specified rate of return (6-5/8% for the year involved) (R. 90) on what is generally known as its "rate base". 15 U.S.C. §717 (a), (d). That rate base is, rather interestingly, the undepreciated original cost of Petitioner's system *less accumulated depreciation* at the rate of 3-1/2% per annum. *Federal Power Com.* v. *Hope Nat. Gas Co.*, 320 U.S. 591 (1944).

The portion of Petitioner's total system FPC rate base of $418,863,501 (R. 96, 284) attributable to its Kansas property for the year 1969 was $123,523,501 (R. 45, 379). Although admitting it to be relevant the Director gave no weight in his determination of value to the rate base upon which Petitioner actually earns (R. 67) and, of course, there is no question that the Director failed to reduce his original cost figures by the $200,000,000 (system) and $60,000,000 (Kansas portion) in depreciation which had

been recognized by Petitioner through reductions in its rate base pursuant to FPC regulations. 15 U.S.C. §717(h).

Petitioner does not contend that it is an easy task to determine the value of its Kansas property for ad valorem tax purposes; it does contend that the utter disregard for due process shown by the administrative agencies and courts of Kansas must not be countenanced. The statutory procedures and value determination factors required by K.S.A. 79-503 are mandatory and the substitution by the Director of a single factor—undepreciated original cost—for determining justifiable value is a denial to the taxpayer of the due process and equal protection of the law guaranteed by the Fourteenth Amendment to the Constitution of the United States. Furthermore, the only persuasive evidence in the record indicates a justifiable value of Petitioner's Kansas property of some $60,000,000 less than the undepreciated original cost figure utilized by the Director. Such a disparity is hardly a "difference of opinion" between the parties, as shrugged the trial court (Appendix G, p. A117), but rather a clear indication that the Director's figure is just that sort of grossly excessive valuation of property for tax purposes which constitutes a denial of due process under *Great Northern R. Co.* v. *Weeks*, 297 U.S. 135 (1936).

2. The Kansas Supreme Court Has Approved a Policy and Practice of Classifying and Assessing the Property of Petitioner and Other Interstate Natural Gas Pipeline Companies Separately from the Mass of Property in the State in a Manner Which Discriminates in Favor of Other Taxpayers in Kansas, in Contravention of the Constitutions of Kansas and the United States.

The Constitution of Kansas requires uniform and equal rates of assessment of all property in the State and does not permit separate classifications of property

for ad valorem tax purposes (with certain exceptions not here relevant). Article 11, Section 1, Appendix H, p. A121. The Director assessed Petitioner's property and property of other natural gas pipeline companies at the statutory maximum assessed ratio of 30% (K.S.A. 79-501, 79-1439), while the mass of property in the state was consistently assessed at substantially lower rates.

Petitioner, asserting that its constitutional right to uniform and equal rates of assessment had been violated, placed into evidence before the Board the State Real Estate Assessment Ratio Study ("State Ratio Study") (R. 206 et seq.). The purpose of the State Ratio Study is to reflect the relationship, on a county-by-county basis, of assessed value to fair market value of real property (Petitioner's property is assessed as real property for ad valorem tax purposes). The State Ratio Study is an official publication which has been compiled for 27 years and which is prepared and kept current by the Director in compliance with statutory mandate. K.S.A. 79-2437. The State Ratio Study showed that the average assessment ratio for the entire state was 18% and that the average ratio of assessment was 19.8% in the counties traversed by Petitioner's pipeline system (R. 243).

The reliability of the State Ratio Study was confirmed by the testimony of the Director and the Director's expert economist, who were called as witnesses by Petitioner. The Director's expert economist, who was Chairman of the Department of Economics of Wichita State University and who during the preceding two and one-half years had prepared the State Ratio Study for the Director, testified that the State Ratio Study is "highly reliable" (R. 73). Sales not "indicative of the true market value of the real estate sold" are excluded from the State Ratio Study as required by K.S.A. 79-1435. The accuracy and reliability

of the State Ratio Study is further verified through a procedure wherein each county is afforded an opportunity to challenge findings as to the ratio of assessment in an administrative hearing prior to official publication in the State Ratio Study. K.S.A. 1968 Supp. 79-1441a. The Director admitted that the ratio figures shown in the State Ratio Study are correct for what they show and there was no evidence that the State Ratio Study was not reliable (R. 60).

Notwithstanding overwhelming evidence of the reliability of the State Ratio Study and the fact that no other evidence was introduced on the question of general uniformity and equality of assessment, the Kansas Supreme Court held that the State Ratio Study was "not conclusive" on the question of lack of uniformity (Appendix A, p. A12) and denied Petitioner relief on an interesting basis. The Director had introduced evidence which tended to show that other interstate pipelines had also been assessed at the statutory maximum (State's Exhibit E, R. 379). The Kansas Supreme Court held that "the record discloses no evidence which would justify a finding that there was not a good faith attempt *to equalize the assessment of appellant's property and property of other pipeline companies*" (emphasis added) (Appendix A, p. A13).

Classification of property for ad valorem tax purposes is not permitted under the Kansas Constitution, Article 11, Section 1, and the Kansas Supreme Court's approval of the use of an assessment ratio of 30% to assess the property of interstate pipelines as a separate class in the face of uncontroverted evidence that a much lower assessment ratio was used for virtually all other taxpayers in the state is the rankest form of discrimination. No system of taxation which allows such wide discrepancies in treat-

ment between those who are subject thereto can meet the fundamental test of fairness required by the Constitutions of Kansas and the United States. Furthermore, "good faith" of the taxing officials does not validate an illegal assessment; a failure to comply with the mandate of the Kansas Constitution and the mandate of the legislature that property shall be assessed uniformly and equally is *per se* constructive fraud. *Addington* v. *Board of County Commissioners*, 191 Kan. 528, 533, 534, 382 P.2d 315 (1963).

And, while exact uniformity is not possible, the Kansas legislature has provided guidance as to a permissible degree of tolerance in the appraisement and assessment of real property. Thus, K.S.A. 79-1426 provides criminal sanctions for various taxing officials, including the Director, in the event of a willful or knowing failure to appraise and assess property according to law. That section provides that "a variance of 10%, of 30% [i.e. 3%] shall be considered a violation of this section". In the face of such a pronouncement, it would seem undeniable that a variance of 10.2% (the 30% at which Petitioner was assessed less the 19.8% average of the Kansas counties in which is located Petitioner's Kansas pipeline property) constitutes a lack of uniformity and equality of appraisal and assessment for civil purposes. Chief Justice Fatzer, in his dissent in *Northern Natural Gas Company* v. *Williams*, found the court-condoned policies and practices of the state taxing officials, which permitted a 9% variance in a case also involving an interstate natural gas pipeline company, to be "protracted and flagrant disregard of the legislative mandate, and an adopted policy of illegality and constructive fraud. . . ." Appendix in Nos. 71-1104 and 71-1105, p. A92 (not yet reported).

The denial to Petitioner of a ratio of assessment on its pipeline system at a rate uniform with the great mass of underassessed property in the State is condemned as a denial of due process and of equal protection under such cases as *Sioux City Bridge Co.* v. *Dakota County*, 260 U.S. 441 (1923). As was said in *Sunday Lake Iron Co.* v. *Wakefield Twp.*, 247 U.S. 350, 352-353 (1918), ". . . it must be regarded as settled that intentional systematic undervaluation by state officials of other taxable property in the same class contravenes the constitutional right of one taxed upon the full value of his property".

3. Excessive Valuation of Natural Gas Pipeline Property and Application of an Unlawful Assessment Ratio Thereto Discriminates Against the Ratepayer-Citizens of Other States in Favor of Other Kansas Taxpayers and Produces Monetary Consequences Which Constitute an Undue Burden on Regulated Interstate Pipeline Business in Contravention of the Commerce Clause of the Constitution of the United States.

The ultimate effect of the acts of the Kansas taxing officials is to pass on an excessive portion of the local Kansas tax burden to the interstate operations of Petitioner and other pipeline companies and thus to their ratepayers and shareholders. If the decision of the Kansas Supreme Court is permitted to stand, the regulated interstate business of Petitioner and other pipeline companies operating in Kansas will be subjected to a substantial and continuing discriminatory burden. The monetary effect of this action, if it is sustained, will be borne by ratepayers in other states, which is not only discrimination in favor of Kansas residents against residents of the other states which Petitioner and the other interstate pipeline companies serve, but improperly inflates that "just and reasonable" rate for energy which federal regulation is intended to produce. The enormity of this discrimination and its impact on this

Petitioner alone can best be demonstrated by the following tabulation:

	Petitioner's Position	Director's Determination	Excess
System Value	$437,500,000[5]	$634,300,388[6]	$196,800,388
Kansas Portion (29.47%)	128,931,250[5]	186,928,324[6]	57,997,074
Assessed Value	28,224,341	56,078,497	27,854,156
1969 Tax	1,561,803	3,090,636	1,528,833

Petitioner, even though an instrumentality of interstate commerce, must, of course, bear a proportionate part of the tax burden of the states in which it does business, including the State of Kansas. However, the State of Kansas may not lawfully require Petitioner to bear more than its fair share of that state's tax burden. The overvaluation of Petitioner's property, plus the use of a greater assessment percentage than that applied to other property in Kansas, results in the imposition on Petitioner of a disproportionate tax burden which is so excessive that it constitutes an undue burden on interstate commerce in contravention of the Commerce Clause. *Norfolk & Western R. Co.* v. *Missouri Tax Com.*, 390 U.S. 317 (1968).

The decision of the Kansas Supreme Court should be reversed so that Petitioner's property may be valued at its justifiable value and then assessed and equalized with the mass of property of the taxpayers of the State of Kansas.

---

5. Per appraisal by Petitioner's expert witness whose figures were slightly in excess of Petitioner's FPC rate base amounts of $418,863,501 (System) and $123,523,501 (Kansas).

6. Undepreciated original cost.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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*Counsel upon whom service should be made.

Supreme Court, U. S.
FILED
MAR 9 1972
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No. 71-71-1152

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

vs.

RONALD F. DWYER, Director of Property Valuation of The State of Kansas, et al.,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

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APPENDIX A

INITIAL OPINION OF THE SUPREME COURT OF KANSAS IN PANHANDLE EASTERN PIPE LINE COMPANY v. DWYER

No. 46,257

PANHANDLE EASTERN PIPE LINE COMPANY, A Corporation, *Appellant*, v. RONALD F. DWYER, Director of Property Valuation of the State of Kansas; STATE BOARD OF TAX APPEALS OF KANSAS and STATE BOARD OF EQUALIZATION OF KANSAS; and CHARLES B. JOSEPH, RALPH McCARTY, EUGENE E. LEE, and WILLIAM D. ANDERSON, JR., the Members of the State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas; and JOHN E. ROYSTON, Attorney and Secretary of the State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas, *Appellees*.

SYLLABUS BY THE COURT

(Filed May 15, 1971)

1. TAXATION—*Matters of Taxation*—Administrative in *Character*. Matters of taxation, especially assessments, are administrative in their character and should remain free of judicial interference in the absence of fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud.

2. SAME—*Assessment of Properties—No Evidence of Unreasonable or Arbitrary Acts—Uniformity or Equality in the Assessment*. In an appeal by an interstate gas pipeline company from an assessment of its properties located in Kansas by the taxing authorities the record is examined and it is *held*, (1) there was no evidence that the taxing authorities' acts in arriving

at the assessment were unreasonable, arbitrary or capricious, and (2) the record does not disclose a lack of uniformity or equality in the assessment.

3. SAME—*Evidence of Ratio Studies—Not Conclusive.* Evidence of ratio studies, provided by K.S.A. 79-1436, standing alone, is not conclusive in establishing a basis for comparison in determining uniformity of values for assessment purposes.

Appeal from Johnson district court, division No. 5, PHILLIP L. WOODWORTH, Judge. Opinion filed May 15, 1971. Affirmed.

John S. Seeber, of Adams, Jones, Robinson and Manka, of Wichita, argued the cause, and *C. A. Conoley*, of Kansas City, Missouri, was with him on the brief for the appellant.

Clarence J. Malone, Chief Attorney for the Property Valuation Department, argued the cause, and *John L. Bingham*, Attorney for the Property Valuation Department, and *John E. Royston*, Attorney and Secretary of the State Board of Tax Appeals, were with him on the brief for the appellees.

The opinion of the court was delivered by

HATCHER, C.: This is an appeal from a judgment of the district court of Johnson County, Kansas, upholding an order of the State Board of Tax Appeals which determined the state-wide 1969 ad valorem assessment of the appellant's interstate natural gas pipeline property located in Kansas.

The primary issue presented for this court's determination is whether the trial court erred in not finding that the order of the State Board of Tax Appeals (hereinafter

referred to as the Board) was unreasonable, arbitrary or capricious in not granting the appellant relief from the order.

The facts leading up to this appeal will be stated.

The appellant operates an interstate pipeline system originating in gas fields in the Texas and Oklahoma panhandles and the Hugoton field in southwest Kansas. From Liberal, Kansas the appellant operates four parallel pipelines running through twenty-six counties in Kansas and extending through the states of Missouri, Illinois, Indiana and Ohio and into southeast Michigan where it serves an area in and about Detroit.

The Federal Power Commission at this time controls and limits the earnings which appellant is permitted to make by limiting appellant to a rate of return of 6⅝% on the original cost of its property less depreciation. Any buyer of plaintiff's property would also be limited to the same earnings base and rate as appellant now has. The F.P.C. requires depreciation to be taken at the rate of 3½% per year on appellant's property in Kansas, and the rate base on which appellant is permitted to earn is reduced each year by additional mandatory depreciation except for net adjustment made to increase original cost less depreciation as a result of replacements of items that are part of the system or for new construction. All figures relating to the original cost and depreciation of appellant's entire system used by both parties have as their basic source appellant's annual report filed with the F.P.C.

Appellant filed with the Director of Property Valuation, on statements and schedules prescribed by the director, a report showing a "Return Value" of $30,967,805.00 for 1969 for properties in the state of Kansas. The director, by an order dated May 28, 1969, assessed appel-

lant's tangible properties in the state of Kansas for 1969 in the sum of $56,078,497.00.

Appellant timely appealed to the Board on June 27, 1969, from the findings, rulings, orders, decisions and other final action of the director pursuant to K.S.A. 74-2438. On August 1, 1969, the Board, having heard all the evidence presented by appellant and the director on said appeal, entered its final order August 20, 1969, denying the appeal.

The appellant then appealed the order of the Board to the district court of Johnson County, where part of its property is located. The appellant challenged the order of the Board as unreasonable, arbitrary or capricious and sought relief therefrom under the provisions of K.S.A. 1970 Supp. 74-2426.

The trial court concluded:

". . . All factors specified by K.S.A. 79-503 for determining of justifiable value were considered by the assessing authorities.

"The use by the Board of a 5% capitalization rate was a matter of judgment and not unlawful.

"The factor of F.P.C. control on the income earnings of the appellant (F.P.C. rate base of original cost less accrued depreciation) was considered as an element of the Board's valuation and appraisal.

"The system market value approach or unit method is best suited for valuation of plaintiff's property for its entire system and an allocation made on the percentage of the original cost in Kansas bears to the original cost of the entire system, and the correct Kansas allocation percentage is 29.47%.

"The market approach and net stock and debt approach to value were not used or applied by either party, and should not be used or applied in this matter, and was not pertinent under the evidence before the Board.

"This is a review of an order of the Board of Tax Appeals which involves not only the assessment of the appellant's property for taxation but also the question of equalization of that assessment, and it is the performance of a highly technical administrative function.

"Under K.S.A. 79-709, after the completion of an assessment it must be apportioned not only to the several counties but to the townships, cities, school districts and other taxing districts which is determined by a formula which apportions to each taxing district that part of the total assessment as is proportionate to the total length of lines within the taxing district. The District Court should not undertake to 'substitute its judgment' for the determinations of the Director of Property Valuation and the findings of the Board of Tax Appeals, or to impose a method of distribution which is incomplete under statutory requirements.

"The Court further finds that the order of the Board of August 20, 1969, appealed from herein, with respect to plaintiff, was not unreasonable, was not arbitrary, and was not capricious. Said order was lawful and applied required statutory standards of value to plaintiff's property. The order was also reasonable and not arbitrary or capricious in all respects, and in accordance with the evidence before it. There was ample evidence to support said order and findings of and by the Board.

"There is no evidence that the Board of Tax Appeals has been guilty of doing acts under the influence of a corrupt motive, or acted with unreasonable, arbitrary or capricious conduct; and therefore the administrative decision should be upheld by this Court.

"The record indicates only a difference of opinion as to the amount of assessment and there is nothing in the record to justify a conclusion by the Court upon review that the Board of Tax Appeals in this case has not exercised good faith and rendered an opinion honestly formed."

The appellant has now appealed to this court raising substantially the same issues.

Before considering the specific objections we will give attention to the limited extent of this court's power to review.

The statute under which this appeal is taken, K.S.A. 74-2426, closes with the following statement:

". . . In hearing and considering any such appeal, the court shall not enforce or give effect to any rule or regulation which it shall find to be unreasonable, arbitrary or capricious."

However, regardless of the statute it has always been the rule of this court that matters of taxation, especially assessments, are administrative in their character and should remain free of judicial interference in the absence of fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud. (*Harshberger v. Board of County Commissioners*, 201 Kan. 592, 442 P. 2d 5; *Mobil Oil Corporation v. McHenry*, 200 Kan. 211, 436 P. 2d 982.)

In the early case of *Symns v. Graves*, 65 Kan. 628, 70 Pac. 591, we stated at page 636 of the opinion:

> ". . . Matters of assessment and taxation are administrative in their character and not judicial, and an interference by judges who are not elected for that purpose with the discharge of their duties by those officers who are invested with the sole authority to make and estimate value is unwarranted by the law. The district court could not substitute its judgment for that of the board of equalization, and this court cannot impose its notion of value on either. These are fundamental principles in the law of taxation and cannot be waived aside to meet the exigencies of any particular case. . . ."

Unless there has been fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud in the assessment, the courts cannot interfere.

Appellant first contends—

> "The trial court erred in finding the order of the Board of Tax Appeals determining the assessment of Appellant's property in Kansas was not unreasonable, arbitrary or capricious under Chapter 368 of the Laws of Kansas 1969 when the pertinent mandatory statutory factors for determining the justifiable value required by K.S.A. (1964) 79-501 and K.S.A. 1968 Supp. 79-503 which in common experience determine and control the justifiable value of Appellant's property, were not considered, applied, or followed, and were totally ignored, lost sight of, or willfully abandoned by the Board."

In considering the merits of this appeal, it is necessary to have before us K.S.A. 79-501 (Laws of 1963, Chapter 460, § 3) which provides in part:

"Each parcel of nonexempt real property shall be valued at its justifiable value in money, the value thereof to be determined by the assessor from actual view and inspection of the property; but the price at which such real property would sell at auction or forced sale shall not be taken as the criterion of such justifiable value. . . ."

K.S.A. 1968 Supp. 79-503 provides how justifiable value shall be determined as follows:

"Justifiable value shall mean the value of real estate which is arrived at after applying factors hereinafter set forth.

"To arrive at the justifiable value of real property the assessor or appraiser shall actually view and inspect the property. The price at which real property would sell at auction, forced sale or any transaction in which personal elements were a factor regarding the sale price shall not be taken into consideration in determining the justifiable value. In determining the justifiable value of real property, the assessor or appraiser shall consider that value in money arrived at when the following factors or combinations thereof are considered:

"(*a*) The proper classification of lands and improvements;

"(*b*) the size thereof;

"(*c*) the effect of location on value;

"(*d*) depreciation, including physical deterioration or functional, economic or social obsolescence;

"(*e*) cost of reproduction or improvements;

"(*f*) productivity;

"(*g*) earning capacity as indicated by lease price or by capitalization of net income;

"(*h*) rental or reasonable rental values;

"(*i*) sale value on open market with due allowance to abnormal and inflationary factors influencing such values;

"(*j*) comparison with values of other property of known or recognized value; and

"(*k*) valuations of land and improvements on the basis of the foregoing elements and such other elements as may be just and proper.

"It shall be unlawful to determine justifiable value of real property in any manner other than authorized and provided for in this section. Any person authorized to assess or equalize property shall consider class, location, productivity, rental values and capitalization."

The appellant contends that "(*d*) depreciation, including physical deterioration or functional, economic or social obsolescence; (*e*) cost of reproduction or improvements; (*f*) productivity; (*g*) earning capacity as indicated . . . by capitalization of net income;" and "(*j*) comparison with values of other property of known or recognized value;" are pertinent factors listed in the statute and should have been given consideration.

Our attention is called to *Garvey Grain, Inc. v. MacDonald*, 203 Kan. 1, 453 P. 2d 59, in which we held the standards prescribed by the statute may not be ignored by taxing officials.

The commission contends and the trial court found that—"all factors specified by K.S.A. 79-503 for determin-

ing justifiable value were considered by the assessing authorities."

We have some difficulty in finding the basis for appellant's contentions.

The appellant's expert witness capitalized his anticipated income of $30,383,113.00 at a rate of 7% and got a value on the income approach of $434,044,400.00. He made certain adjustments and arrived at a value of $437,500,000.00 for the total plant. He then took 29.47% of that amount as the indicated values of operating properties within the state of Kansas and arrived at a value of $128,931,250.00. He next took 30%, the assessment ratio for Kansas, of the total value in Kansas and arrived at assessment for properties in Kansas of $38,373,865.00.

The Board's expert witness capitalized his anticipated income of $29,854,000.00 at a rate of 5% and got a value on the income approach for the property in Kansas of $186,928,324.00 after certain adjustments. He then took the assessment ratio of 30% and arrived at an assessment for properties in Kansas of $56,078,497.00.

The chief difference in the results obtained by the two experts is the rate used for capitalization of income. The net operating income for 1969 was used by the Board's expert witness—$29,854,662.00. The appellant's expert witness took the past five years and arrived at an average income of $30,383,113.00. The difference was not material. The difference in the rate used of 2% resulted in a difference in value of $150,000,000.00 for the system at large, or a difference in the value of the property in Kansas of slightly less than $50,000,000.00. We have used round figures to stay within the realm of our ability to calculate. Neither do our figures take into consideration adjustments for materials and supplies, etc.

If the Board was not guilty of unreasonable, arbitrary or capricious conduct in using the 5% figure for capitalizing income this court should not interfere with the assessment order.

The trial court found that the use by the Board of a 5% capitalization rate was a matter of judgment and not unlawful. We are inclined to agree.

The appellant argues that the assessment should be close to the rate base and therefore the rate of capitalization should be at least equal to the rate of return.

The Board argues that a prudent purchaser would be satisfied with a lower rate of return on investment if he knew at the same time he would receive annually a partial return of the investment. We do not care to engage in an argument over a statement made in good faith by the Board.

When the Board used the income approach, there was reflected in the results reached physical functional productivity and economic depreciation.

The Board's engineer also used original cost and reproduction cost less depreciation and the weighted results arrived at a comparable figure.

A careful examination of the record discloses no showing by appellant which would justify a finding of unreasonable, arbitrary and capricious conduct on the part of the Board in using the capitalization rate of 5%.

The appellant next contends that the Board and the trial court erred in failing to use the median real estate assessment ratio of the official sales ratio study for the assessment ratio in each county in which appellant had property in order to provide a uniform rate of assessment

and taxation of appellant's property in each county under Article 11, Section 1, of the Kansas Constitution.

We are forced to conclude that the ratio study standing alone is not conclusive as to value. In *Cities Service Oil Co. v. Murphy*, 202 Kan. 282, 447 P. 2d 791, we held:

> "Ratio studies provided for by K.S.A. 79-1436 are proper evidence of justifiable value but such evidence, standing alone, is not conclusive in establishing a basis for comparison in determining uniformity of values for assessment purposes." (See, also, *Beardmore v. Ling*, 203 Kan. 802, 457 P. 2d 117.)

It might also be suggested that the 1969 legislature passed a law (K.S.A. 79-503 [*j*]) not made applicable to this case, stating:

> ". . . The ratio study shall not be used as an appraisal for appraisal purposes."

It would at least indicate the legislature was not out of harmony with the decisions of this court.

There are too many speculative elements involved and too few properties are subject to sale for the ratio study to be relied on for appraisal purposes. It may, however, serve as a signal that a reappraisal is in order.

We are forced to conclude that the appellant has not by the ratio study alone presented sufficient evidence of inequality to justify a reduction of their assessment apportioned to the various counties.

The appellant complains that:

> "The trial court erred in failing to find the order of the Board of Tax Appeals was unreasonable, arbitrary, or capricious because of the fact the order on its face and the evidence conclusively proves the

Board failed to equalize the assessed value of Appellant's property with property of other similar companies."

The Board concluded and the conclusion was approved by the trial court:

"The taxpayer has the burden of proof and has failed to sustain the burden of proof to establish by evidence that the assessment lacks uniformity."

A careful search of the record by us discloses no evidence which would justify a finding that there was not a good faith attempt to equalize the assessment of appellant's property and property of other pipeline companies. It is disclosed the sixty-two pipelines have been appraised by the Kansas taxing authorities using the factors that were used here in arriving at the assessed value. It would result in real lack of uniformity if a single taxpayer were assessed on a different basis. It would serve no useful purpose to attempt to state what is not in the record or to attempt a justification of one isolated appraisal of the old Board as affecting the appraisals of the new Board.

The judgment is affirmed.

APPROVED BY THE COURT.

KAUL, J., dissenting: I dissent from the holding stated in subsection (1) of paragraph 2 of the syllabus for the reason that the assessment was not made in accordance with the mandate of K.S.A. 79-503.

As indicated in the majority opinion, this court has repeatedly said matters of taxation especially assessments are administrative in character and should remain free of judicial interference in the absence of fraud. It is equally true that this court has frequently said that assessment of property for taxes must be made in accordance with

the provisions of applicable statutes and where taxing officials fail in this respect the issue presented to the court is not the exercise of their administrative judgment, but the legality of their acts. *(Garvey Grain, Inc. v. MacDonald*, 203 Kan. 1, 435 P. 2d 59.)

The controlling issue in this case is whether the control of appellant's earnings by the Federal Power Commission was recognized in determining the justifiable value of appellant's property by the taxing authorities involved.

It was admitted by Director Dwyer and Mike Gillgannon, an expert witness called by the State Board of Tax Appeals, that FPC control of earnings was a factor to be considered under 79-503 *(d)*. On this point Dwyer testified as follows:

> "Q. What is your definition of economic obsolescence, Mr. Dwyer?
>
> "A. Well economic obsolescence is a loss in value generally due to conditions outside the property itself.
>
> "Q. Yes. And is it not a fact that a control that is exercised by the Federal Power Commission, which limits a company's earnings to its rate base of original cost less depreciation, is a factor affecting the earnings and economic value of the company outside of the property itself?
>
> "A. Yes.
>
> "Q. And is it not also true that when you consider a trended method, that if you are using, I believe, what was used here, a Handy Whitman Index, you are trying to show what it would cost to reproduce, actually reproduce the same line and everything today, with the cost index being of 1911, as equal to one hundred?

"A. I think that is correct, yes, sir, for the reproduction part.

"Q. And is it not true that when you arrive at the reproduction cost. that the economic obsolescence of the Federal Power Commission limiting the earnings to original cost less depreciation is not reflected in the trended approach?

"A. If you stop there, it is reflected in the trended approach, but if you stop merely at the reproduction, it is not reflected at that time, no sir."

The Board's expert Gillgannon was questioned on the point by reference to Dwyer's testimony as follows:

"Q. Now, were you present when Mr. Dwyer the Property Valuation Director testified?

"A. Today?

"Q. Yes.

"A. Yes, I was here.

"Q. He testified that the earnings base of the Federal Power Commission, of the earnings rate of six and five-eighths percent on original cost less depreciation reflected an economic obsolescence with respect to this company's property, do you agree with this statement?

"A. I would agree to that, yes."

Although it was admitted to constitute economic obsolescence, I am unable to find FPC control reflected or recognized by Gillgannon in his calculations of the three approaches—income, cost and reproduction cost less depreciation which he used as correlated value indicators with allocated mathematical weights of twenty. forty and forty percent, respectively, in arriving at justifiable value.

In calculating reproduction cost less depreciation, Gillgannon did use a three and one-half percent depreci-

ation rate in which he says he allowed one percent for functional obsolescence and one-half of one percent for economic obsolescence. However, he made no claim that either allowance reflected the abnormal factor of FPC control of appellant's earnings based on a rate base of original cost less depreciation.

Despite the admissions of Director Dwyer and Gillgannon previously referred to, the trial court in Finding No. 33 found that "F.P.C. regulation and control does not constitute functional, economic or social obsolescence."

Time does not permit a discussion of appellant's evidence. It will suffice to say the undisputed evidence discloses that because of the abnormal factor of FPC control, appellant is limited to earnings of six and five-eighths percent on a rate base equal to the original book cost of its property less accrued depreciation. F.P.C. control was admitted by appellees to fall within the scope of economic obsolescence under K.S.A. 79-503 *(d)*. It was not applied as a factor in assessing appellant's property.

In Finding No. 34 the trial court found—"The rate base of FPC or any other regulatory body is not named in K.S.A. 79-503 as one of the factors to be considered." It is true that 79-503 does not mention the rate base of a regulatory body as a factor to be considered. However, in addition to what has been said with respect to subsection *(d)*, subsection *(g)* specifically enumerates "earning capacity as indicated by . . . capitalization of net income," as a factor to be considered. In his calculation of capitalization of net income, Gillgannon used a capitalization rate of five percent. It should be kept in mind that the use of a lower capitalization rate results in a higher value indicator, while the effect of the use of a higher rate is conversely a lower indicator. On cross-examination Mr.

Gillgannon admitted that prudent investors would have wanted a rate of seven and one-half percent or more. Gillgannon failed to supply any satisfactory explanation for his choice of a five percent capitalization rate. In view of the limitation on appellant's earnings, Gillgannon's arbitrary choice of a five percent capitalization rate appears unrealistic and reflects a further failure to consider an obviously pertinent factor enumerated in 79-503.

In view of our holding in *Garvey Grain, Inc., v. MacDonald*, supra, the judgment should be reversed.

FATZER and SCHROEDER, J. J., join in the foregoing dissent.

APPENDIX B

ORDER OF THE SUPREME COURT OF KANSAS GRANTING MOTION FOR REHEARING

No. 46,257

IN THE SUPREME COURT OF THE STATE OF KANSAS

PANHANDLE EASTERN PIPE LINE COMPANY,
a Corporation,
Appellant,

v.

RONALD F. DWYER, DIRECTOR OF PROPERTY VALUATION OF THE STATE OF KANSAS, et al.,
Appellees.

ORDER

(Filed June 16, 1971)

Upon consideration, and for good cause shown, the appellant's motion for rehearing is sustained, and the case set for oral argument on Tuesday, September 21, 1971. Counsel for the parties may file new briefs on the specific questions involved at their option.

BY ORDER OF THE COURT

Dated at Topeka, Kansas, this 16th day of June, 1971.

APPENDIX C

OPINION ON REHEARING OF THE SUPREME COURT OF KANSAS IN PANHANDLE EASTERN PIPE LINE COMPANY v. DWYER

No. 46,257

PANHANDLE EASTERN PIPE LINE COMPANY, a Corporation, *Appellant*, v. RONALD F. DWYER, Director of Property Valuation of The State of Kansas; STATE BOARD OF TAX APPEALS OF KANSAS and STATE BOARD OF EQUALIZATION OF KANSAS; and CHARLES B. JOSEPH, RALPH McCARTY, EUGENE E. LEE, and WILLIAM D. ANDERSON, JR., the Members of The State Board of Tax Appeals of Kansas and The State Board of Equalization of Kansas, and JOHN E. ROYSTON, Attorney and Secretary of The State Board of Tax Appeals of Kansas and The State Board of Equalization of Kansas, *Appellees*.

OPINION ON REHEARING

(Filed December 11, 1971)

Appeal from Johnson district court, division No. 5, PHILLIP L. WOODWORTH, judge. Opinion on rehearing filed December 11, 1971. Original opinion affirmed. (For original opinion, see *Panhandle Eastern Pipe Line Co. v. Dwyer*, 207 Kan. 417, 485 P. 2d 149.)

John S. Seeber, of Adams, Jones, Robinson and Manka, of Wichita, argued the cause, and *C. A. Conoley*, of Kansas City, Missouri, was with him on the appellant's brief on rehearing.

Clarence J. Malone, chief attorney for the Property Valuation Department, argued the cause, and *John L. Bingham*, attorney for the Property Valuation Department, was with him on the appellees' brief on rehearing.

C. Maxwell Logan and *James K. Logan*, of Payne and Jones, Chartered, of Olathe; and *James Butler* and *Frank Saunders, Jr.*, of Wallace, Saunders, Austin, Allen, Brown and Enochs, of Overland Park, filed a brief on behalf of the Taxpayer's Association of Johnson County, Kansas, *amicus curiae*.

The opinion of the court was delivered by

FOTH, C.: Appellant's motion for rehearing was granted in order to permit the court to consider the issues raised in this case in the broader context of those presented by several other pending cases involving the ad valorem taxation of state-assessed utilities. After careful reconsideration of the record, the arguments and the briefs, the court is convinced its initial decision was correct. The original opinion is therefore affirmed.

APPROVED BY THE COURT.

O'CONNOR, J., participated in the decision of this case and approved the foregoing opinion on rehearing prior to his resignation.

PRAGER, J., took no part in the consideration or decision of this case.

SCHROEDER, J., concurring: After reconsideration of this case in the broader context of other ad valorem tax cases involving state assessed utilities pending before the court, I now join in the majority decision written for the court. (See *Panhandle Eastern Pipe Line Co. v. Herren*, 207 Kan. 400, 485 P. 2d 156; *Panhandle Eastern Pipe Line Co. v. Dwyer*, 207 Kan. 417, 485 P. 2d 149; *Northern Natural Gas Co. v. Williams*, 208 Kan. ....., ... P. 2d .....; *Northern Natural Gas Co. v. Bender*, 208 Kan. 135, 490 P. 2d 399; and *Northern Natural Gas Co. v. Dwyer*, 208 Kan. ....., ... P. 2d .....)

My reasons briefly stated follow:

When this case was originally decided the court expressed an opinion that it was the Director's order which was subject to review where appeal had been perfected to the district court pursuant to K.S.A. 1970 Supp. 74-2426. (See *Panhandle Eastern Pipe Line Co. v. Herren*, supra, at p. 404.) The opinion on this point has since been modified. (*Panhandle Eastern Pipe Line Co. v. Herren*, 208 Kan. 119, 490 P. 2d 416.)

It is now established that an appeal pursuant to 74-2426, *supra*, authorizing an appeal from an order of the State Board of Tax Appeals to the district court, presents the limited issue as to whether the *order of the Board* appealed from is "unreasonable, arbitrary or capricious." Whether the State Board of Tax Appeals determines a matter of property valuation before it as an appeal board or as a board of equalization, it functions independently of the Director of Property Valuation in matters of administrative judgment and decision. (*Northern Natural Gas Co. v. Dwyer*, supra.)

Under these circumstances statements that may be regarded as admissions by the Director are not binding on the Board. Thus, what was construed as an admission by the Director—that Federal Power Commission regulation of the utility constituted economic obsolescence—was an erroneous premise used to support my dissent. There is no economic obsolescence by reason of F.P.C. regulation of Panhandle Eastern Pipe Line Company as demonstrated in *Northern Natural Gas Co. v. Dwyer*, supra, where the growth of Panhandle has been similar to the growth of Northern.

The capitalization rate of 5% used by the Director in this case involving Panhandle Eastern Pipe Line Company was not satisfactorily explained by the evidence in the record. It appeared when the decision was originally written that the selection of a 5% capitalization rate was purely arbitrary. Reconsideration of this case in the context of other ad valorem tax cases pending before the court discloses a valid basis for the capitalization rate used by the Department of Property Valuation and considered by the Board in making its determination. (See *Northern Natural Gas Co. v. Dwyer*, supra.)

It is impossible for me to agree, however, with the consideration given by the court to the issue involving the official sales ratio study for state assessed utility property. On this point my views are briefly expressed in my concurring opinion in *Northern Natural Gas Co. v. Dwyer*, supra.

FATZER, C. J., dissenting: Time does not permit a lengthy discussion of the reasons why the original opinion in *Panhandle Eastern Pipe Line Co. v. Dwyer*, 207 Kan. 417, 485 P. 2d 149, was erroneous. As the court's opinion indicates, a rehearing was granted to consider the issues in the case in the context of issues and the records in other cases involving the 1969 ad valorem assessment of state-assessed natural gas pipe line utilities—particularly *Northern Natural Gas Company v. Dwyer*, infra, and related cases, and the rehearing in *Panhandle Eastern Pipe Line Co. v. Herren*, 207 Kan. 400, 485 P. 2d 156.

The order of the Board of Tax Appeals sustaining the Director of Property Valuation's 1969 state-wide assessment of Panhandle, and denying that utility's appeal therefrom, was entered August 20, 1969, which was the same day the Board entered its order sustaining the Director's 1969 state-wide assessment of Northern Natural

Gas Company and denying that utility's appeal to the Board. The language of the Board's order in *Panhandle* is identical with the language of the Board's order in *Northern*, except for the name of the utility and the first two paragraphs in the Northern order which contain recitals of its interstate character, and that it is regulated for rate purposes by the Federal Power Commission and the State Corporation Commission.

It may be said that as a legal matter, both orders are identical and are wholly insufficient to comply with the mandatory provisions of K.S.A. 1969 Supp. 74-2426, requiring the Board to *make findings of fact upon which it based its determination.* Moreover, the mandatory requirements of K.S.A. 79-503 were completely ignored. The record in *Northern* discloses without dispute, that the 1969 ad valorem assessments of Panhandle and Northern were based upon a directive of the Director of Property Valuation to value or assess those utilities at 30 per cent of non-depreciated original cost. My dissenting opinion in *Northern Natural Gas Co. v. Dwyer* [No. 46,450], 208 Kan. ....., ... P. 2d ....., this day decided, is adopted as the dissenting opinion in this case.

KAUL, J. (dissenting): I adhere to my dissent filed with the original opinion in this case. (*Panhandle Eastern Pipe Line Co. v. Dwyer*, 207 Kan. 417, 424, 485 P. 2d 149.) However, in view of the court's decision in *Northern Natural Gas Co. v. Dwyer*, 208 Kan. ....., ... P. 2d ....., this day decided, in which I have joined, an explanation appears to be appropriate. My dissent herein is based on the premise that the record discloses the Director of Property Valuation, by his own admissions, ignored the mandate of K.S.A. 79-503 and on the further ground that the Director's choice of 5% capitalization rate was not supported by any explanation or logical reasoning, thus

compelling the conclusion that it was arbitrary. Even though the State Board of Tax Appeals is said to function independently of the Director in the matters of administrative judgment and decision, its rulings in the instant case are not supported by the evidence and in fact are contrary thereto.

While the central issues in the instant case are essentially the same as those framed in *Northern Natural Gas Co. v. Dwyer,* supra, the records in the two cases reveal marked differences in the evidence produced and in the findings of the respective trial courts. In particular the admissions of the Director and his expert which showed a disregard of 79-503 in the *Panhandle* case do not appear in the *Northern* record, and the Director's choice of 5.5% rate in capitalizing the net income of *Northern* has a basis in the record as carefully pointed out by the trial court in its Finding No. 4, whereas in *Panhandle* the 5% rate was an arbitrary choice with no basis established nor any explanation given.

In short, the issue to be determined on judicial review is whether the order of the *Board* is shown to be "unreasonable, arbitrary or capricious"; the respective records in the two cases show that the burden was sustained in *Panhandle* but not in *Northern.*

APPENDIX D

OPINION OF THE SUPREME COURT OF KANSAS IN NORTHERN NATURAL GAS COMPANY v. DWYER

No. 46,450

NORTHERN NATURAL GAS COMPANY,
Appellant,

vs.

RONALD F. DWYER, DIRECTOR, PROPERTY VALUATION DEPARTMENT, OR HIS SUCCESSOR IN OFFICE, AND THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS,
Appellees.

SYLLABUS BY THE COURT

(Filed December 11, 1971)

1.

The assessment and valuation of property are administrative functions, not judicial ones, and courts will not substitute their judgment for that of the assessing authorities in the absence of fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud.

2.

The State Board of Tax Appeals is the highest administrative tribunal established by law to determine controversies relating to assessments of property for ad valorem tax purposes.

3.

K.S.A. 1970 Supp. 74-2426 authorizing an appeal from an order of the Board of Tax Appeals to the district court, is construed as authorizing an appeal from an order of an administrative tribunal, in accordance with prior decisions of this court, on the limited issue as to whether the *order of the Board* appealed from is "unreasonable, arbitrary or capricious."

4.

In construing K.S.A. 1970 Supp. 74-2426, and adhering to the court's prior decisions, the rules of evidence (Art. 4) of the new code of civil procedure apply in the trial of an ad valorem tax action brought to the district court by an appeal pursuant to K.S.A. 1970 Supp. 74-2426, and the district court may receive and consider any evidence relevant to the limited issues presented upon review of the administrative order or decision.

5.

Under certain circumstances when the evidence is written, documentary in character, or in the form of depositions or transcripts the appellate court's duty is to decide for itself what the facts establish, substantially as it would in an original case.

6.

K.S.A. 1970 Supp. 74-2426 requires the State Board of Tax Appeals to make written findings of the fact forming the basis of its determination and final order, and such finding shall be made a part of such final order.

7.

K.S.A. 79-422 requires that public utility property be listed and taxed as provided by law for real estate.

8.

K.S.A. 79-501 provides for the valuation of nonexempt real property at its justifiable value in money.

9.

K.S.A. 1968 Supp. 79-503 provides for the determination of justifiable value in accordance with directions to consider certain enumerated factors or combinations thereof.

10.

K.S.A. 79-1439 (L. 1963, ch. 460, §1) requires that all real and tangible personal property, which is subject to general property taxes, shall be assessed uniformly and equally at 30% of its justifiable value.

11.

In determining the validity of assessments of real property for taxation the essential question is whether the standards prescribed by K.S.A. 1968 Supp. 79-503 have been considered and applied by taxing officials, or intentionally and grossly disregarded.

12.

Compliance with the provisions of K.S.A. 1968 Supp. 79-503 is mandatory upon assessing officials in assessing real property, but the factors or combinations thereof to be considered in determining justifiable value may not all be pertinent to a specific property. What factors apply depends upon the individual type of property, after consideration has been given to all of the factors.

13.

Economic obsolescence is the *loss in usefulness* of an asset occasioned by the approach to the stage of economic

uselessness through progress of the arts; economic inutility arising from external causes. Obsolescence refers to *disappearing usefulness* resulting from invention, change of style, legislation, or other causes having no physical relation to the object affected.

14.

Cases recognize a definite distinction between the valuation of public utility property for rate making purposes, determined pursuant to statutes applicable thereto, and the valuation of the same property pursuant to different statutes for ad valorem tax purposes.

15.

The valuation of property on a state-wide basis of a public utility by the Board of Tax Appeals of the state of Kansas pursuant to applicable statutes, and in particular K.S.A. 1968 Supp. 79-503 is reviewed on appeal and it is found that the Board of Tax Appeals gave consideration to all factors enumerated in 79-503 and applied the pertinent factors.

16.

It is apparent the legislature by enacting K.S.A. 1968 Supp. 79-503 intended to avoid the effect of abnormal and inflationary factors which influenced the values of real property subject to ad valorem taxation.

17.

The recognition of a "bench mark" by the Property Valuation Department of the state of Kansas in the appraisal of public utility property for ad valorem tax purposes, resulting from many years of experience, is not objectionable or unlawful.

18.

Whether the State Board of Tax Appeals determines a matter of property valuation before it as an appeal board or as a board of equalization, it functions independently of the Director of Property Valuation in matters of administrative judgment and decision.

19.

Ratio studies provided by K.S.A. 79-1436 are proper evidence of justifiable value but such evidence, standing alone, is not conclusive in establishing a basis for comparison in determining uniformity of values for assessment purposes.

20.

The record in an ad valorem tax action, wherein the State Board of Tax Appeals valued and assessed public utility property on a state-wide basis, appealed to the district court pursuant to K.S.A. 1970 Supp. 74-2426 is reviewed on appeal and it is *held* the order of the State Board of Tax Appeals from which the appeal was taken is not unreasonable, arbitrary or capricious, and the action of the Board in the valuation and assessment of the public utility's Kansas property came within the realm of administrative judgment.

Appeal from Pawnee district court; MAURICE A. WILDGEN, judge. Opinion filed December 11, 1971. Affirmed.

Mark H. Adams, II, of Adams, Jones, Robinson and Manka, of Wichita, argued the cause, and *William S. Richardson*, of the same firm, and *F. Vinson Roach* and *Frank J. Duffy*, of Omaha, Nebraska, were with him on the brief for the appellant.

Clarence J. Malone, of Topeka, Chief Attorney, Property Valuation Department, argued the cause, and *John L. Bingham*, of Topeka, Attorney, Property Valuation Department, and *John E. Royston*, of Topeka, Attorney, State Board of Tax Appeals, were with him on the brief for the appellees.

The opinion of the court was delivered by

SCHROEDER, J.: This is an appeal in an ad valorem tax case from an order of the district court of Pawnee County, Kansas, upholding an order of the State Board of Tax Appeals determining the statewide 1969 ad valorem assessment of the appellant's interstate natural gas pipeline operating property located in Kansas.

The underlying question on appeal is whether the assessment of the appellant's operating property in Kansas should be invalidated on the ground that the order of the Board of Tax Appeals is unreasonable, arbitrary or capricious.

The interstate gas pipeline and distribution property of Northern Natural Gas Company (appellant) located in twenty-six Kansas counties, including Pawnee County, Kansas, was initially assessed by the Director of Property Valuation (hereafter the Director) in the amount of $67,528,850 by his order dated May 15, 1969. The foregoing valuation and assessment was appealed by Northern to the Board of Tax Appeals (hereafter the Board) pursuant to authority granted by K.S.A. 74-2438. On the 31st day of July, 1969, the Board heard Northern's appeal and on the 20th day of August, 1969, affirmed the Director's assessment. In so doing, the Board adopted the same justifiable value and assessment that had been made by the Director.

Thereafter, pursuant to K.S.A. 1970 Supp. 74-2426 (effective April 25, 1969), Northern appealed to the district court of Pawnee County from the Board's order approving the valuation and assessment of the Director on the ground that the order was "unreasonable, arbitrary or capricious."

Before the case could be heard in the district court, Northern's first half of the 1969 ad valorem taxes fell due. Northern paid these taxes under protest and duly and timely commenced refund actions pursuant to K.S.A. 79-2005 in each of the twenty-six counties in which its Kansas properties were located. One of these actions has been tried on the merits and appealed to this court; another has come to the court on a procedural point. They have been considered and determined in connection with this appeal and should be read in conjunction herewith. The Rice County action, determined on the merits, is reported in *Northern Natural Gas Co.* v. *Williams,* 208 Kan. ....., ... P.2d ..... The Clay County action, determined on a procedural point, is reported in *Northern Natural Gas Co.* v. *Bender,* 208 Kan. ....., ... P.2d .....

Two other related cases should be studied in connection with this opinion. They are *Panhandle Eastern Pipe Line Co.* v. *Dwyer,* 207 Kan. 417, 485 P.2d 149; and *Panhandle Eastern Pipe Line Co.* v. *Herren,* 207 Kan. 400, 485 P.2d 156.

The case at bar was tried in the district court on the 18th day of March, 1970, and the trial court after confining its consideration of the matter to the record made before the Board, and certain other matters of which the Board admittedly had judicial knowledge, on the 30th day of July, 1970, found specifically and generally against Northern and denied Northern's appeal.

Northern's post-trial motions assigned as a ground for reconsideration the discovery of substantial, material evi-

dence not available at the time of the hearing before the Board, whereby it attempted to pinpoint the fraud, or its equivalent, involved. It is Northern's contention that this newly discovered evidence, consisting of the deposition of the Director's utility appraisal expert, Mike Gillgannon, conclusively demonstrated that the Board did not follow the statutory mandates in arriving at Northern's justifiable value, but rather determined the justifiable value of Northern's operating property in Kansas to be the amount of the original cost undepreciated, and from such predetermined figure worked back by giving lip service to the statutory factors listed under K.S.A. 1968 Supp. 79-503, and manipulating the weight given to alleged indicators of value.

Upon hearing the post-trial motions the trial court withdrew its original order and reconsidered the matter. Contrary to its initial rulings in the case, confining the evidence to the record before the Board, it granted Northern the right to take Gillgannon's deposition and required the Director to produce documents for inspection, copying or photocopying. Questions concerning the admission of evidence under the code of civil procedure were passed until such time as the evidence was marshaled and offered. The trial court thus reversed its original position and allowed Northern's motion for discovery at the post-trial stage of the proceedings. All evidence adduced by Northern as a result of the discovery was admitted in evidence by the trial court and is made a part of the record herein.

While the trial court admitted such evidence, it adhered to its original position and refused to consider the evidence marshaled on discovery upon the ground that the Board had not had an opportunity to consider such evidence at its hearing. In this respect the trial court said:

". . . I am going to exercise my right and prerogative to not consider anything whatsoever in this appeal that may be disclosed by your discovery, that the Board of Tax Appeals did not consider. In other words, I am sticking to my original tenet, that I don't think the Board of Tax Appeals should be considered to be acting in an arbitrary, capricious, discriminatory manner when it was not given an opportunity to consider evidence. . . ."

The foregoing ruling of the trial court raises a procedural point asserted by the appellant which commands our attention.

This court has consistently adhered to the principle that the assessment and valuation of property are administrative functions, not judicial ones, and that courts will not substitute their judgment for that of the assessing authority in the absence of fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud. This principle has been based upon the considerations of constitutional law, on the nature of the assessment and valuation functions, and on an inherent lack of power in courts. (*Mobil Oil Corporation* v. *McHenry,* 200 Kan. 211, 436 P.2d 982.)

The State Board of Tax Appeals is the highest administrative tribunal established by law to determine controversies relating to assessments of property for ad valorem tax purposes. (*Mobil Oil Corporation* v. *McHenry,* supra.)

The statute here applicable, K.S.A. 1970 Supp. 74-2426, provides in part:

"[1] Whenever the board of tax appeals shall enter its final order on any appeal, *said board shall make written findings of the fact forming the basis*

of such determination and final order and such findings shall be made a part of such final order. [2] Within ten (10) days after its decision the board shall mail a copy of its order by registered or certified mail to the person, firm, corporation or association who was a party to such appeal. [3] Within thirty (30) days after the mailing of the final order of the board, *any party to such appeal may appeal to the district court of the proper county.* [4] *Provided, That no such appeal may be taken to the district court from any order* determining, *approving,* modifying or equalizing *the assessment of property for property tax purposes unless such order is unreasonable, arbitrary or capricious;* . . .

". . . [5] Appeals from any final order made by the board as to ad valorem tax liability shall be to the district court of the county in which the property involved is located, or if located in more than one county, then to the district court of any county in which any portion of the property is located. . . . [6] The appeal shall be taken by filing, with the clerk of the district court of the proper county, a written notice stating that the party appeals to the district court and alleging the pertinent facts upon which such appeal is grounded. [7] Upon filing of the notice of appeal, the director shall be deemed to be a party to such appeal, and the clerk of the district court shall docket the cause as a civil action, and shall forthwith and without praecipe issue summons and cause the same to be served upon the director, in accordance with the manner now provided by law in civil cases. [8] *Jurisdiction to hear and determine such appeals is hereby conferred upon the district courts of this state. Such an appeal shall be heard as an equity proceeding, and shall proceed as*

an original action. Trial may be had or any order made in term or vacation.

"[9] *The district courts are empowered to appoint referees,* either standing or special, *to hear the evidence and recommend findings of fact and conclusions of law. The transcript of the proceedings had at the hearing before the board of tax appeals may be admissible in evidence.* . . . [10] In hearing and considering any such appeal, the court shall not enforce or give effect to any rule or regulation which it shall find to be unreasonable, arbitrary or capricious." (Emphasis and numbers in brackets are added to facilitate further discussion.)

Despite the provisions in 74-2426, *supra,* making the Director a party to an appeal from an order of the Board (No. 7), it is the *order of the Board* which is the subject of review in the district court on appeal (Nos. 3 and 4). By statute the State Board of Tax Appeals has no capacity or power to sue or be sued. (K.S.A. 1970 Supp. 74-2433; see, also, *Cities Service Oil Co.* v. *Kronewitter,* 199 Kan. 228, 428 P.2d 804.) (The order of the trial court making the Board a party defendant, notwithstanding; and the Board's refusal to enter an appearance are inconsequential.) The Board's decisions are administrative in nature, and are subject to limited review just as decisions of other administrative tribunals. This is clearly the import of the provision in 74-2426, *supra,* authorizing appeal to the district court from a final order of the Board approving an assessment of the Director on the condition that the order be "unreasonable, arbitrary or capricious" (No. 4). The provisions (No. 8) conferring jurisdiction upon the district courts to hear such appeal *as an equity proceeding,* and to proceed with such hearing as an *original action* do not detract from this interpretation. The limited review of an

administrative decision of the State Board of Tax Appeals in an ad valorem tax case in the district court was referred to in *Mobil Oil Corporation* v. *McHenry*, supra, as an *equity proceeding* at page 227 of the official report where *Symns* v. *Graves*, 65 Kan. 628, 70 Pac. 591, was quoted. The mere fact that the statute authorizing appeal refers to the proceeding in the district court as an *original action* (No. 8) does not broaden the scope of review or change the nature of the proceeding. This is clearly the thrust of *Lauber* v. *Firemen's Relief Association*, 202 Kan. 564, 451 P.2d 488; and *Rydd* v. *State Board of Health*, 202 Kan. 721, 451 P.2d 239.

It may summarily be stated, therefore, on the facts here presented 74-2426, *supra*, authorizing an appeal from an order of the Board of Tax Appeals to the district court, must be construed as authorizing an appeal from an order of an administrative tribunal, in accordance with prior decisions of this court, on the limited issue as to whether the order of the Board appealed from is "unreasonable, arbitrary or capricious." In hearing and considering such appeal the district court is admonished that it shall not enforce or give effect to any rule or regulation which it shall find to be unreasonable, arbitrary or capricious (No. 10).

An attempt has been made by this court to construe statutes authorizing appeals from the decisions of various administrative agencies, boards and tribunals of the state to the district court with some consistency in the area of administrative practice and procedure. In *Keeney* v. *City of Overland Park*, 203 Kan. 389, 454 P.2d 456, the court observed:

> "Over the years, the scope of judicial review of actions by administrative bodies had been of perplexing concern to the bench and bar of this state.

The confusion has apparently arisen because of the creation of an ever increasing number of administrative agencies, boards and tribunals, each with its own peculiar statutory provisions. The present case, like others reaching this court recently (see, *e.g.*, *Rydd* v. *State Board of Health*, supra [202 Kan. 721, 451 P.2d 239]; *Lauber* v. *Firemen's Relief Association*, supra [202 Kan. 564, 451 P.2d 488]; *Kansas State Board of Healing Arts* v. *Foote*, supra [200 Kan. 447, 436 P.2d 828]; *Board of County Commissioners* v. *Brookover*, 198 Kan. 70, 422 P.2d 906; *Moyer* v. *Board of County Commissioners*, supra [197 Kan. 23, 415 P.2d 261]; *Lira* v. *Billings*, 196 Kan. 726, 414 P.2d 13), clearly demonstrates the need for legislation providing for greater uniformity in the areas of administrative practice and procedure and judicial review of administrative decisions." (p. 395.)

In *Keeney* the district court, after noting that a transcript of the hearing before the city council in a zoning matter was available, and apparently relying on our decision in *Bodine* v. *City of Overland Park*, 198 Kan. 371, 424 P.2d 513, ruled that the transcript before the city council would be admissible in evidence, and further, that the court would confine itself only to evidence relating to the matters heard by the city governing body along with any exhibits or documentary evidence that were likewise submitted and considered by the council in making its decision. It was said, however, the district court misconstrued our decision in *Bodine* with respect to what evidence may be considered on appeal to the district court from the decision of an administrative tribunal. In *Keeney* the court said:

"The rules of evidence (Art. 4) of the new code of civil procedure, apply to the proceeding in district court. (*Bodine* v. *City of Overland Park*, supra [198 Kan. 371, 424 P.2d 513].) These rules recognize as a fundamental principle that the primary test of admissibility of evidence is its relevancy to the issue in dispute, and that all relevant evidence is admissible unless limited by the various exclusionary rules. (See, Gard, Kansas Code of Civil Procedure, Annotated, §60-407, pp. 370, 371.) Thus, a district court, in determining the reasonableness of the action of a city governing body, is not necessarily limited to those matters considered by the city fathers. Within the framework of issues made up by the pleadings or at pretrial conference, the court may receive and consider any evidence relevant to the limited question of reasonableness. The test of relevancy should not depend on the availability of a full and complete transcript of the proceedings before the city governing body. In actual practice, the proceedings may or may not be recorded. If a record is made, as it was here, it is relevant and admissible in the district court. Parties attacking the reasonableness of an ordinance should not be precluded from the presentation of relevant evidence showing unreasonableness, even though such evidence was not presented to the governing body. This is not meant to imply that the hearing in district court should be a retrial on the merits of the zoning application, irrespective of whether or not a record was made of the city council's proceedings; neither does it imply that a party may lie in wait and ambush the other side at the district court hearing. The district judge remains armed with his usual discretion in admitting or rejecting evidence, and his rulings will not be disturbed unless substan-

tial rights of a party are thereby affected. (See, *Bodine* v. *City of Overland Park,* supra.)" (p. 394.)

On the hearing of an appeal in the district court from an order of the State Board of Tax Appeals, the provisions of 74-2426, *supra,* authorizing the district court to appoint referees to hear the evidence, and further reciting that the transcript of the proceedings had at the hearing before the Board of Tax Appeals *may* be admissible in evidence (No. 9), inferentially indicate the legislative intent of the statute to be in accordance with the rules stated in *Bodine* v. *City of Overland Park,* supra; *Rydd* v. *State Board of Health,* supra; and *Keeney* v. *City of Overland Park,* supra.

Therefore, in construing 74-2426, *supra,* and adhering to our prior decisions, we hold the rules of evidence (Art. 4) of the new code of civil procedure apply in the trial of an ad valorem tax action brought to the district court by an appeal pursuant to 74-2426, *supra,* and the district court may receive and consider any evidence relevant to the limited issues presented upon review of the administrative order or decision.

Board of County Commissioners v. *Brookover,* 198 Kan. 70, 422 P.2d 906, upon which the trial court relied, must stand on its own peculiar facts. There the Board of County Commissioners of Shawnee County was denied injunctive relief in an action against the State Board of Tax Appeals. The State Board of Tax Appeals on complaint of a resident taxpayer had previously directed the Board of County Commissioners to reappraise all Shawnee County real estate subject to a general property tax, uniformly and equally at thirty percent of its justifiable value pursuant to K.S.A. 79-1439. (Note the Board was not sitting as an appeal board.) A complete record was made

before the administrative board at a hearing, where all parties had a full opportunity to present their evidence, and the resulting order of the Board was challenged in the district court because it was *not supported by the evidence* and constituted an act that was arbitrary, capricious, oppressive, illegal and so grossly contrary to public interest as to constitute constructive fraud. On such issue the court said bad faith was not indicated by evidence which was not before the Board for consideration at the time its decision was made. The Board of County Commissioners there asserted an extraordinary legal remedy because no remedy by appeal from such an order was available. By amendment, effective April 25, 1969, 74-2426, *supra*, authorizes an appeal, on the facts here presented, from the Board's decision in an ad valorem tax matter appealed to the Board, and this court is called upon to construe the provisions authorizing an appeal of this nature.

Accordingly, we conclude the trial court should have considered the deposition of Gillgannon and other documentary evidence discovered by the appellant in its determination of the limited issue before it. The evidence excluded was clearly relevant and went directly to the issue presented in the trial court. This is not to say the trial court was required to give such evidence credence, in whole or in part.

The foregoing infirmity does not, however, preclude further review on appeal. All of the evidence presented to the Board which the trial court considered (the transcript, the exhibits and documentary matters of which the Board had judicial knowledge), and all of the evidence which the trial court refused to consider on appeal from the order of the Board in this case (the deposition of Gillgannon and his working papers) was documentary in form. This court has recognized that under certain circumstances

when the evidence is written, documentary in character, or in the form of depositions or transcripts its duty is to decide for itself what the facts establish, substantially as it would in an original case. (*Boese* v. *Crane,* 132 Kan. 777, 324 P.2d 188; *Watson* v. *Dickey Clay Mfg. Co.,* 202 Kan. 366, 450 P.2d 10; *Thompson* v. *Thompson,* 205 Kan. 630, 470 P.2d 787; and cases cited in these decisions.)

On this state of the record the Supreme Court will review the entire record to ascertain whether the order entered by the Board was "unreasonable, arbitrary or capricious," substantially as it would in an original action. In this context the deposition of Gillgannon and other documentary evidence rejected by the trial court in reaching its decision will be reviewed along with the other evidence presented in the record to determine the matter.

Another procedural point is asserted by the appellant. It is claimed the Board in entering its final order on appeal from the decision of the Director of Property Valuation failed to make written findings of fact forming the basis of such determination and final order as required by 74-2426, *supra* (No. 1).

While the Board did make what was denominated written findings of fact, our analysis of its written findings discloses they are mere conclusions which fail to give the basis for its determination and final order. The findings should have been specific setting forth the factual basis for the Board's determination. But on the record here we do not regard the failure of the Board to make basic findings of fact fatal to further review. (See *Cities Service Gas Co.* v. *State Corporation Commission,* 201 Kan. 223, 440 P.2d 660.)

The appellant in its brief observes there is apparently no substantial dispute between the parties with respect to

the facts. The appellant says the dispute is largely over the manner in which the undisputed facts are to be applied. The valuation and assessment of the appellant's Kansas operating properties were determined from the rendition made by the appellant to the Director of Property Valuation as required by law. The rendition was identical to the annual report of the appellant submitted to the Federal Power Commission for the year ending December 31, 1968, and to the annual report of the appellant submitted to the State Corporation Commission for the same year. The method used in arriving at the valuation and assessment of the appellant's property by the Director was presented in the form of evidence to the Board hearing the appeal from the Director's order.

Inferentially the conclusions, denominated findings of fact made by the Board and entered as a part of its order approving the Director's valuation and assessment, indicated the factual basis upon which the order was entered. The method by which the appellant's Kansas operating properties were valued and assessed was the basis of the appellant's attack in the trial court. There is nothing mysterious in the record concerning the factual basis for the Board's order or the method by which the appellant's Kansas operating properties were valued and assessed. Our review of the record will disclose and discuss it at some length.

Mike Gillgannon was the Director's expert utility appraiser. His duties as an employee of the Property Valuation Department specifically involved the valuation of pipeline companies for the Director. In 1969 he appraised and assessed sixty-three companies. He appraised and assessed Northern's property and his determinations made under the supervision of the Director were fully adopted by the Director. The Board heard Northern's appeal and in

approving the assessment of Northern's property by the Director thereby adopted the same justifiable value and assessment that had been made by the Director.

It should be noted our review of the record is to determine whether the Board's order is unreasonable, arbitrary or capricious; but since the Director by statute is a party to this appeal and not the Board, for whom the Director appears, our discussion will refer occasionally to the Director's appraisal, assessment or action. These references should not be misconstrued to alter the fact that the court is in reality reviewing the order of the Board.

Northern says in its brief:

> ". . . Northern's position essentially is that the evidence establishes fraud or its equivalent, requiring a judgment setting the order of the Board aside and invalidating it."

Northern is a "natural-gas company" engaged in the transportation of natural gas for resale in interstate commerce. Its pipeline and interstate gathering facilities are located in several midwestern states and are regulated by the Federal Power Commission (F.P.C.) under the Natural Gas Act (15 U.S.C. §717, *et seq.*). Under this regulation it is permitted to earn only a specific rate of return computed on a "rate base" which in general terms is referred to in the record as "original cost less depreciation." This depreciation for all practical purposes here under consideration is 3 1/2% straight line annual depreciation. As of January 1, 1969, Northern's effective F.P.C. rate of return was approximately 6.8% of the F.P.C. rate base. Within Kansas, Northern, through its Peoples Division, is also regulated by the Kansas Corporation Commission, which permits Northern to earn only upon a rate base of the depreciated original cost of the property at a rate of 6.5%.

Northern's annual report as of December 31, 1968, filed with the F.P.C. discloses a "Total Gross Utility Original Cost Investment" of $1,069,274,448. It also shows a deduction for "Depreciation, Amortization and Depletion" of $345,201,339, thus yielding an F.P.C. rate base ("Total Net Utility Original Cost Investment") of $724,073,109. Of this total 20.89% is attributable to Kansas. Computed, this amounts to $148,755,008 or $151,258,872, depending upon the treatment of materials and supplies and gas stored underground outside Kansas.

The foregoing figures are undisputed and the parties concede that Northern's properties must be appraised on a system-wide basis, allocating the proper portion to each state. The amount attributable to Kansas is undisputed.

Northern's income statement for the year ending December 31, 1968, made in its annual return to the Director under the heading "Utility Operating Income" shows "Operating Revenues" of $302,790,644 for the entire utility system. "Total Operating Expenses" are shown as $254,303,138. The calculation reveals "Net Operating Revenues" of $48,487,506. Among the "Operating Expenses" listed and deducted from "Operating Revenues" are: "Depreciation expense" of $35,223,898; "Income taxes" of $14,609,500; "Provision for deferred income taxes" of $425,000; and "Income taxes deferred in prior years—Credit" of $5,181,000.

The foregoing lines (numbered) in the annual return to the Director are specifically defined in the F.P.C. "Uniform System of Accounts." The Director calls our attention to the F.P.C. regulations which permit recapture in cash from gross revenues of depreciation, amortization and income taxes (current and future) as being peculiar and explainable only as a part of a rate fixing format. The Director contends they should *all* be considered by an

appraiser striving to determine the system-wide justifiable value.

From the rendition submitted to the Director by Northern, identical to the annual F.P.C. report, the Director's determination of Northern's Kansas justifiable value was $225,096,190. Applying a 30% rate to the determination of justifiable value resulted in an assessed valuation by the Director of $67,528,850.

Gillgannon used two approaches to arrive at his appraisal of Northern's operating properties. All expert appraisal witnesses, including Northern's, conceded the market data approach was not applicable to the appraisal of pipeline utility properties because there is no evidence of comparable sales. Gigantic public utilities of this nature are not sold in the open market. According to Gillgannon's sworn testimony before the Board, supported by his working papers introduced as exhibits, he arrived at the justifiable value of Northern's operating property in Kansas (1) by trending the cost of Northern's property, and (2) by capitalizing the 1968 net utility operating income of Northern at 5.5%. He then assigned a weight of 85% to the trended cost figure, and 15% to the capitalized income indicator to arrive at a justifiable value of $225,096,190. This determination of justifiable value exceeded the original *undepreciated cost* of Northern's property in Kansas by approximately $3,000,000. Gillgannon also recognized that the Director's determination of justifiable value exceeded the "depreciated" original cost of Northern's Kansas property by approximately $76,000,000.

The trended cost of Northern's Kansas property was determined by Gillgannon as follows:

> "Trended cost is synonymous with reproduction cost less depreciation. The process is started by

using original cost as a base. This figure is trended or indexed according to the Handy Whitman Index. It is then depreciated by 3.5% and to this amount is added the amount of new investment or new plant for that year, representing the reproduction cost less depreciation for the current year. The process is simply repeated each year thereafter. The process was started with an original cost figure of 1947, which was the earliest data available to the Department. . . .

"For the first year (1947), the original cost total plant was indexed by one. In other words, the current trended cost cumulated was identical with the original cost for the year 1947. In 1948, according to the January edition of the Handy Whitman Transmission Index, there was an index value of 1.101. This index was applied to the previous year's original cost of $32,101,573. This amount was depreciated 3.5% by applying the factor .965. To this was added the new plant, which had been added between the years 1947 and 1948. The resulting figure, which was a trended cost figure for 1948, was $38,568,853. In 1949, this last figure was indexed up by 1.056, which was the relative change in the Handy Whitman Index between the years 1948 and 1949. The resulting figure was again depreciated by .965 and to this was added the new plant of $5,916,575. This yielded a trended cost cumulated of $45,219,979. By use of this trended cost method, I arrived at a trended cost value of $232,-101,655."

It is to be noted the 3 1/2% depreciation used by Gillgannon to arrive at his trended cost was calculated on the declining balance method.

A prior decision of this court in 1963 discussing trended original cost and cost of reproduction new less depreciation in determining proper standards of valuation for rate making purposes is *Southwestern Bell Tel. Co.* v. *State Corporation Commission*, 192 Kan. 39, 386 P.2d 515.

The reason assigned by Gillgannon for using the reproduction cost less depreciation as distinguished from the "depreciated" original cost was stated as follows:

"A. Well, I feel that in most instances, the original cost is not as valid a measure, or at least has less validity as a measurement of value than reproduction cost less depreciation, for several reasons. Original cost, at the time of the new construction of a project, would probably be of primary value then, because it should represent the actual cost as of that moment, or that time, but as time goes on, the value of original cost, it diminishes, principally because of two factors that immediately start to work on this particular cost item; one is the effect of inflation, the other is the factor of depreciation, and this, over the years, would tend to minimize the validity of original cost in itself as a true measurement of value.

"Q. In using the reproduction cost new less depreciation, do you use a trending method, and if so, tell what it is, and how you use it?

"A. Well, this is the one particular factor I think that enhances the value of reproduction cost less depreciation measure over that of original cost, because of the trending factor that we use, which in itself, appreciates the property according to changes in today's dollar, or it accounts for the inflationary effects."

Gillgannon's testimony discloses the Property Valuation Department also used another trending index known as the Engineering News Record Index. These indices are generally accepted by engineers and tax commissions throughout the country and they supply a practical method to determine trended value. The yields result in negligible error. The Handy Whitman Index was designed primarily to apply to the electrical industry as well as to the gas industry. For that reason the Handy Whitman Index was given preference in trending the values in the gas pipeline industries.

Northern does not question the Handy Whitman Index used by Gillgannon. It merely questions the application of it to the facts in this case.

The Director calls our attention to evidence in the record which supports the use of the trended cost valuation approach and why this approach should be given great weight. Northern's annual report for the year 1968 discloses that its *earnings* on common stock per share from operations increased from 1 cent per share in 1932 to $3.98 per share in 1968. Except for a few minor adjustments the earnings progressively increased year after year. In 1948 the earnings per share were $1.56, and the increase in earnings per share since that time *has all occurred under F.P.C. regulation.* In 1948 the market price of its common stock ranged from a high of 18 1/8 to a low of 12 7/8. Each year since 1948 the market price of Northern's common stock, considering only the high, progressively increased until 1965 when its high was 65 1/2 and its low was 57. In 1966 the high was 59 1/4 and the low was 41 3/8. In 1967 the high was 54 and the low was 44 5/8. In 1968 the high was 59 1/2 and the low was 48 1/4. Similarly, the dividends paid on common stocks per share since 1948 have increased gradually from 90 cents to $2.60 per share in 1968.

The gross value of Northern's property in 1930 was $20,100,000. In 1948 it was $102,600,000, and in 1968 it was $1,270,700,000. Its miles of pipeline increased from 4,900 miles in 1948 to 25,200 miles in 1968. Its gas reserves estimated in trillions of cubic feet increased from 4.3 in 1948 to 14.6 in 1965. The system's salable capacity in millions of cubic feet of gas daily increased from 437 in 1948 to 2,487 in 1968. The number of communities served by Northern in 1930 was 44; the number served in 1948 was 242; and in 1968 it had increased to 1,051 communities served. In 1968 alone 17 new communities were added which it served.

Northern's record is clearly one of constant growth and by far the largest portion of this growth was accomplished under F.P.C. regulation.

In explaining the 9.5% capitalization rate Gillgannon testified before the Board:

> "A. The cap rate, as established, was premised to a large extent on the cost of long term debt and total capital over a five-year average, and much of the capital structure of companies today, I believe, represents old term debt, much of it at two and a half percent, four percent, and so forth. And this cap rate actually represents capitalization of net income with depreciation extracted from that net income, so in reality, it is a cap rate representing only return on investment, and not return of investment, so if there was an allowable in there for return of investment, it would be a higher rate. I capitalized the 1968 net operating income of Northern Natural.
>
> "Q. For 1968?
>
> "A. Yes. Well, I used that figure—now, there were three different computations of capitalized in-

come, the five-year— I mean, the current—pardon me—year, income capitalized, the three-year average capitalized, and the five-year average capitalized, and I think your question was, which one was used in making a final judgment, and it was the current net operating income capitalized.

"I think current income in most instances probably more accurately and realistically indicates the future income, or prospects of income.

. . .

"In my determination of a 5.5% capitalization rate, I had a five-year average return on equity of 5.74%, the five-year period being consecutively through 1967. The data was extracted for the most part from Moody's, and the companies included Northern Natural Gas Company, Panhandle Eastern and Kansas Power and Light Company. Mr. Morford who was then Supervisor of Utilities was the one who made the choice of the companies and they were chosen because he considered them to be comparable. He did much of the research on it and I'm not sure of all the ingredients that went into it really. It is really true that I accepted a figure of 5.5% on the basis of studies made by somebody else.

"Q. What part of the study did you make?

"A. Well, I reviewed part of the material from Moody's, and I made some of the computations, and actually Mr. Morford made some of the computations, and actually Mr. Morford made the judgment as to the companies to use in the study. The study was made in mid-year of 1968. I think that's a pretty good statement to make, because it was drawn out over a period of time. It wasn't all done at one time.

"Q. (By Mr. Adams) Then you are using a study made in mid-year of 1968 to develop a cap rate for the purpose of capitalizing income as of January 1, 1969, is that correct?

"A. Well, that could be true, yes.

"The figure of 5.18% was based on the five-year average return on the total capital, over the same five-year period by Mr. Morford. The equity figure of 5.74% is really a price-earnings ratio."

Immediately following the above testimony of Gillgannon before the Board Counsel for Northern stated: "For the record, I have decided to release the Director, Ron Dwyer, from the subpoena. I don't believe we will need his testimony." Northern had subpoenaed Dwyer *duces tecum*. The subpoena directed him to produce "all of the documents, schedules, forms, writings, memoranda, assessment sheets, work papers, valuations, records, or other thing or things" pertaining to Northern's 1969 valuation "that may show, or purport to show, the method or formula used by the State in determining the valuation and assessment of such property."

Northern contends the original cost less depreciation of Northern's property allocated to Kansas constitutes the ceiling beyond which a determination of value in the state of Kansas cannot be validly made. It is argued that until such time as the regulatory commissions involved allow a rate of return comparable to the current demand of the investor, the actual justifiable value of Northern's property in Kansas must continue to be less than its original cost less depreciation.

Northern attempts to establish through its expert witnesses that neither the F.P.C. nor the Kansas Corporation Commission will consider any evidence of value whatso-

ever (for rate making purposes) except original cost less straight line depreciation, because this is the rate base upon which Northern is permitted to earn a return on its investment. Northern contends it is pointless to compute and unreasonable to consider reproduction cost less depreciation as an indicator of value for an F.P.C. regulated company.

It is interesting to note the position taken by the public utility in a rate case before the Kansas Corporation Commission where trended original cost and reproduction cost new less depreciation are asserted in the valuation of its property for *rate making* purposes. (See *Southwestern Bell Tel. Co.* v. *State Corporation Commission,* supra.)

Northern's expert witness, Dr. Herbert B. Dorau, testified that currently and historically the F.P.C. has not allowed a fully adequate rate of return to Northern or to other similarly situated pipeline companies which would allow the return of combined cost of equity, cost of preferred stock and cost of long-term debt equal to *presently demanded* rates of return by prudent investors. He testified that the capitalization of income is ultimately the economic basis for the value of income producing property. He determined Northern's net utility operating income for 1968 by adding the investment tax credit and interest charged to construction, which resulted in an adjusted utility operating income of $52,264,013. He capitalized this figure at the rate of 8.5%, resulting in a capitalized value of Northern's utility property of $614,870,741. The portion allocated to Kansas was $128,426,498. In arriving at the 8.5% capitalization rate Dr. Dorau *examined* the primary money market, the bond market, the cost of preferred stock, and the common stock equity discount rates.

He testified that if a purchaser should happen to pay for Northern's Kansas property the Director's valuation in

the amount of $225,096,190, there is no conceivable way under past and present policy of the F.P.C. that the purchaser could recover the excess over the original cost less depreciation of $151,258,872.

Northern's other expert witness, Browley Travis, appraised Northern's total system property in the amount of $681,098,000, and the Kansas portion thereof in the amount of $142,281,000. He arrived at this value by utilizing on a total system basis the original cost less depreciation of Northern's property, the capitalization of its 1968 net utility operating income at 8.5%, and a computation of the value of Northern's stock and debt for 1969. To this stock and debt indicator value he assigned only 10% weight, while giving 40% to original cost less depreciation and 50% to capitalized income. He testified that reproduction cost had no place in the valuation of a utility regulated by the F.P.C. and its use was unreasonable.

Before proceeding further it is necessary to have the *applicable* statutes in mind.

K.S.A. 79-422 provides that public utility property should be listed and taxed as is provided by law for real estate.

K.S.A. 79-501 provides for the valuation of nonexempt real property at its justifiable value in money.

K.S.A. 1968 Supp. 79-503 provides for the determination of justifiable value as follows:

> "Justifiable value shall mean the value of real estate which is arrived at after applying factors hereinafter set forth.
>
> "To arrive at the justifiable value of real property the assessor or appraiser shall actually view and inspect the property. The price at which real property

would sell at auction, forced sale or any transaction in which personal elements were a factor regarding the sale price shall not be taken into consideration in determining the justifiable value. In determining the justifiable value of real property, the assessor or appraiser shall *consider* that value in money arrived at when the following factors or combinations thereof are *considered*:

"(*a*) The proper classification of lands and improvements;

"(*b*) the size thereof;

"(*c*) the effect of location on value;

"(*d*) depreciation, including physical deterioration or functional, economic or social obsolescence;

"(*e*) cost of reproduction or improvements;

"(*f*) productivity;

"(*g*) earning capacity as indicated by lease price or by capitalization of net income;

"(*h*) rental or reasonable rental values;

"(*i*) sale value on open market with due allowance to abnormal and inflationary factors influencing such values;

"(*j*) comparison with values of other property of known or recognized value; and

"(*k*) valuations of land and improvements on the basis of the foregoing elements and such other elements as may be just and proper.

"It shall be unlawful to determine justifiable value of real property in any manner other than authorized and provided for in this section. Any person authorized to assess or equalize property shall consider class, location, productivity, rental values and capitalization." (Emphasis added.)

K.S.A. 79-1439 (L. 1963, ch. 460, §1) requires that all real and tangible personal property, which is subject to general property taxes, shall be assessed uniformly and equally at 30% of its *justifiable value.*

In determining the validity of assessments of real property for taxation, the essential question is whether the standards prescribed by 79-503, *supra*, have been considered and applied by taxing officials, or intentionally and grossly disregarded. (*Garvey Grain, Inc.* v. *MacDonald*, 203 Kan. 1, 453 P.2d 59.) Compliance with the provisions of the statute are mandatory upon assessing officials in assessing real property, but the factors or combinations thereof to be considered in determining justifiable value may not all be pertinent to a specific property. What factors apply depends on the individual type of property, after consideration has been given to all of the factors.

Northern contends the Director failed to consider the statutory factors: (*d*) depreciation, including physical deterioration or functional, economic or social obsolescence; (*f*) productivity; (*g*) earning capacity as indicated by lease price or by capitalization of net income; (*i*) sale value on open market with due allowance to abnormal and inflationary factors influencing such values; and (*k*) such other elements as may be just and proper.

From Northern's brief its greatest concern under 79-503 appears to be that the Director failed to apply and account for any economic obsolescence. Northern relies upon the testimony of its expert witnesses to the effect that the only cost indicator which made any sense to apply to the facts in this case was *original cost less depreciation.* (Note this factor is not specifically enumerated, but see [*e*].) It is argued to the extent that a reproduction of trended cost was computed exceeding the original cost less depreciation of the same property, it failed to deduct economic obsolescence resulting from regulation.

Economic obsolescence was defined in a New York case dealing with the assessment of real property in *Piazza* v. *Town Assessor of Town of Porter*, 228 N.Y.S.2d 397, 16 A.D.2d 863 (1962). The court there dealt with the definitions of functional and economic obsolescence. It said "functional obsolescence" with respect to the valuation of property for taxation is loss of value brought about by the failure or inability to deliver full service, and includes any loss of value by reason of shortcomings or undesirable features contained within the property itself and is a loss of utility and failure to function due to inadequacies of design and deficiencies in the property. The court said "economic obsolescence" with respect to valuation of property for taxation is a loss of value brought about by conditions that environ a structure such as a declining location or down-grading of a neighborhood resulting in reduced business volume.

Obsolescence in "A Dictionary for Accountants" (3rd Ed.), by Eric L. Kohler, is defined as:

> "The loss in usefulness of an asset, occasioned by the approach to the stage of *economic uselessness through progress of the arts; economic inutility arising from external causes.* Obsolescence refers to *disappearing usefulness* resulting from invention, change of style, legislation, or other causes having no physical relation to the object affected. . . ." (Emphasis added.)

In *Southeastern Bldg. Corp.* v. *Commissioner of Int. Rev.*, 148 F.2d 879 (5th Cir. 1945), it was said:

> ". . . It thus becomes apparent that while the rental value of the property fluctuated, its life is in no wise diminished, *and to grant taxpayer the relief it here seeks would be the equivalent of aiding it to recoup fluctuation losses.* Manifestly, the life of the property has many years to run, and it can be used

throughout its normal life. *The unprofitable nature of a business or the mere shrinkage in value of commodities is not a sufficient basis upon which to predicate an allowance for obsolescence. . . .*" (p. 880.) (Emphasis added.)

Giving consideration to economic obsolescence consistent with its definition in the foregoing authorities and applying it to the facts in the case at bar, we cannot find that Northern is entitled to the economic obsolescense it claims. This finding is fortified by the phenomenal growth of Northern throughout the period of time it has been subjected to F.P.C. regulation.

Regulation by the F.P.C. must in the long run be regarded as flexible. The rate of return can be changed and the rate base can be changed. At some future time the F.P.C. rate base determined on the basis of original cost less 3 1/2% straight line annual depreciation may prove unrealistic and deny the utility the right to earn a fair and reasonable return on its investment. But where the plant and its facilities are rapidly expanding on a system-wide basis, and income taxes and other fringe benefits are deductible from operating revenues before calculating the permissible rate of return, the present F.P.C. formula may be functioning properly for rate making purposes. (*Permian Basin Area Rate Cases*, 390 U.S. 747, 20 L.Ed.2d 312, 88 S.Ct. 1344; *Re Lockport Light, Heat & Power Co.* [1935] 12 P.U.R. [N.S.] 413; *Re Panhandle Eastern Pipe Line Co.* [1954] 3 PUR3d 396; 79 A.L.R.2d 1134; and *Warburton* v. *Warkentin*, 185 Kan. 468, 345 P.2d 992, 79 A.L.R.2d 1114.)

The cases recognize a definite distinction between the valuation of public utility property for rate making purposes, determined pursuant to statutes applicable thereto, and the valuation of the same property pursuant to

different statutes for ad valorem tax purposes. (See *Southwestern Bell Tel. Co.* v. *State Corporation Commission*, supra.)

It is apparent from the record the Director gave consideration to all factors enumerated in 79-503, and applied the pertinent factors. Gillgannon, after arriving at the current value of Northern's property, took a 3 1/2% deduction for depreciation, amortization and obsolescence. This annual depreciation covered all types of depreciation, physical deterioration and obsolescence, both functional and economic.

The factors of productivity and earning capacity as indicated by capitalization of net income were applied by capitalizing the F.P.C. net operating revenues of Northern by 5 1/2%.

The factor of "sale value on open market with due allowance to abnormal and inflationary factors influencing such values" was considered and applied to the extent it was applicable. The parties conceded utility property on a system-wide basis was not sold in the open market, and thus no market data was available. But the value of Northern's common stock as indicated by its listing on the New York stock exchange was applied in determining the 5 1/2% capitalization rate. The allowance for abnormal inflationary factors will be discussed later.

The "cost" approach to which the Director gave 85% weight was determined by using the accepted appraisal technique of "reproduction cost new less depreciation." This approach applied the factor listed in 79-503(e) "cost of reproduction or improvements." Apparently Northern would like to ignore this factor.

The only other factor deserving comment is consideration of original cost. While original cost depreciated was

the basis of Northern's value for F.P.C. rate making purposes, for ad valorem tax purposes, it was considered but found to be inapplicable. The original cost was applied to the extent that it formed the basis for the trended cost. The explanation why Gillgannon relied more heavily on the trended value has been stated.

In 1969 the legislature enacted a new law for the valuation of the property, both real and personal, tangible and intangible, of all public utilities. (K.S.A. 79-5a04 [L. 1969, ch. 434, §4] effective January 1, 1970.) It was amended in 1971. (L. 1971, ch. 295.) The Director argues the valuation of Northern's property followed precisely the policy subsequently adopted by the legislature in the new law.

The Director compared the justifiable value determined for Northern with values of other public utilities as disclosed by Exhibit "C", which was introduced as an exhibit for the state at the hearing before the Board. Exhibit "C" shows the ratio of original assessment to original cost, to depreciated cost and to trended cost of ten gas pipeline public utilities. It shows the ratio of the original assessment to the original cost to be near 30% for all companies, varying less than one percentage point for all except one of the companies. This exhibit discloses the existence of a "bench mark" (hereafter discussed) in the State Department of Property Valuation used to check valuations of public utility properties to see that they are equalized and uniform. For the Kansas-Nebraska Natural Gas Company the ratio was 25.28%. This was occasioned by a reduction in the assessed valuation of this company by the old Board of Tax Appeals (See L. 1969, ch. 369), and of which Northern makes complaint on this appeal.

Another basic premise upon which Northern attacks the valuation and assessment is the capitalization rate used

by Gillgannon and adopted by the Director in the valuation of Northern's Kansas properties. Gillgannon used a 5.5% while Northern's expert witnesses used an 8.5% capitalization rate. This higher capitalization rate was premised upon the theory that it was equal to the *presently demanded rates of return by prudent investors.* Northern argues that even Gillgannon admitted the cost of current money on January 1, 1969, would be between 7 1/2% and 8 1/4%.

While each party attacks the capitalization rate used by the other, it is to be noted both Gillgannon and the expert witnesses for Northern applied their respective capitalization rates to the F.P.C. "Net Operating Revenue" of Northern as heretofore stated.

The 5 1/2% capitalization rate applied by Gillgannon has been fully discussed. In support thereof the Director argues the F.P.C. "Net Operating Revenue" is tax free, because all taxes, including income tax, have been taken out before determining the net figure. He also argues the capitalization rate actually represents capitalization of net income with depreciation extracted from it.

The extent to which fully depreciated property is still in use by Northern's utility system, resulting from accelerated depreciation, represents a return of investment to Northern over and above capital consumed. This is additional income and can be used for capital additions to the utility system.

On this point Justice Hughes in *Lindheimer* v. *Illinois Tel. Co.*, 292 U.S. 151, 78 L.Ed. 1182, 54 S.Ct. 658, said:

> ". . . As the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out

of the proceeds of telephone rates for the ostensible purpose of replacing capital consumed. If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital, on a cost basis, according to the method which spreads that loss over the respective service periods. *But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.*" (pp. 168, 169.) (Emphasis added.)

The record shows compressor stations of Northern at Clifton, Mullinville, Bushton and Sublette, Kansas, to be fully depreciated, yet still in operation. (Total F.P.C. depreciation occurs in slightly over 28 1/2 years.) Their original cost was approximately $47,265,000 total. Under Northern's theory this property has no value for tax purposes, but the Director contends it is producing income and has a value which is subject to ad valorem taxation.

The Director contends the 5 1/2% capitalization rate was comparable to the 5 1/2% yield on tax free United States government bonds on January 1, 1969.

The 8 1/2% capitalization rate asserted by Northern as the proper rate to be used in determining its justifiable value tends to take undue advantage of abnormal inflationary controls prevalent in our economy on January 1, 1969. At that time inflationary psychology had gripped our nation and it was of serious concern to the Federal Govern-

ment. As a result of governmental policy the Federal Reserve Board in an effort to dampen inflation psychology of the people took action to force interest rates higher. A graphic illustration showing the result of action by the Federal Reserve Board may be shown from an exhibit in the record disclosing the bank prime loan rate from 1952 to 1969. As late as November 13, 1968, the bank prime loan rate was 6 1/4%. For a period of approximately two years prior to that date the rate fluctuated narrowly between 5 1/2 and 6%. But from November 13, 1968, the rate began to climb. On December 2, 1968, it was 6 1/2%; on December 18, 1968, it was 6 3/4%; on January 7, 1969, it was 7%; on March 17, 1969, it was 7 1/2%; and on June 9, 1969, it was 8 1/2%.

It is apparent the legislature by enacting 79-503, *supra*, intended to avoid the effect of abnormal and inflationary factors which influenced the values of real property subject to ad valorem taxation. It specifically stated in 79-503 (*i*) "sale value on open market with due allowance to abnormal and inflationary factors influencing such values." By "due allowance" the legislature meant the valuation and assessing officials should discount such influences affecting the valuation of property for ad valorem tax purposes.

Giving due consideration to the foregoing observations and other evidence in the record, we find the application of a 5 1/2% capitalization rate to the F.P.C. net income of Northern to be within the realm of administrative judgment and not unreasonable, arbitrary or capricious.

In an effort to pinpoint the fraud or its equivalent which is attributed to the Board by Northern, it asserts the deposition of Gillgannon, the Director's utility appraisal expert, which it contends conclusively demonstrates that the Board did not follow the statutory mandates in arriving

at Northern's justifiable value, but rather determined the justifiable value of Northern's operating property in Kansas to be the amount of the original cost undepreciated.

On the 20th day of May, 1970, the deposition of Gillgannon was taken under circumstances heretofore related. The trial before the Board of Tax Appeals was conducted on July 31, 1969. In his deposition Gillgannon testified he left the employ of the Kansas Property Valuation Department in February, 1970. In the deposition Northern was attempting to lead Gillgannon into giving certain answers which contradicted his previous testimony before the Board. Gillgannon had testified that the capitalization rate was a rate which a company would feel it had to have for the servicing of all debt; to return the amount of investment in the company over a period of years; and also to allow a reasonable profit to the company. He said he was never completely satisfied that the original depreciated cost was a proper base for determining ad valorem tax value and being guided by this thinking was inclined to give greater consideration to the reproduction cost less depreciation as a measurement of justifiable value. He then testified:

> "Q. Why was more weight given to the cost approach than to the income approach?
>
> "A. Well, actually I believe it was the thinking at the time that the cost approach was more truly representative of company value, but it had been a policy of the—and this is a policy that had been established over the years, that to arrive at and maintain uniformity of assessment and appraisal—or appraisal rather, that we adhere closely to or maintain a level close to original cost. And I might say that the arithmetic values that were applied to—if I were questioned on how I arrived at 85 per cent or 15 per cent, it was largely arbitrary in adjusting a final

result of justifiable value so that they would closely approach 30 per cent of original cost.

"Q. Let me see if I understand your testimony. Are you saying that it was predetermined that the value of this company was going to be approximately 30 per cent of original cost for tax purposes in 1969 in the State of Kansas, and that Defendant's Exhibits 13, 14 and 15 and Defendant's Exhibit 12 are all prepared as an afterthought in an effort to justify the predetermined and arbitrarily arrived at value?

"A. Well, I don't know that— Actually, I suppose it would be construed as predetermined, but really original cost has been over the years considered to be a reliable bench mark in an effort to maintain uniformity in the appraisal of various companies.

"Q. Let me ask this in another way. Are you saying that the work papers and the appraisal process which you went through in order to arrive at a determination of justifiable value of Northern Natural in 1969 in the State of Kansas and the assessment of Northern Natural's properties did not actually play any real part in the fundamental or ultimate determination of that justifiable value which in fact was approximately 30 per eent of original cost?

"A. Well, I wouldn't say that they didn't—didn't play a real part in it, but I will say that the—original cost was very influential in making a final judgment as to what the justifiable value would be.

"Q. I thought your testimony just a moment ago was that 15 per cent weight was given to the capitalized income approach and 85 per cent weight given to the cost approach which was a trended or a RCLD type approach, is that correct?

"A. This is true.

"Q. What weight in the determination of the justifiable value of this company was given to original cost?

"A. Well, there was no arithmetic weight given to it other than that 30 per cent of—or a figure close—or a relative value of 30 per cent of original cost is considered to be—had been considered over the years to be a reliable procedure in effecting a uniform appraisal for all companies.

. . .

"Q. This is to say then, if I am understanding you correctly, that you were directed by Mr. Dwyer to arrive at a justifiable value determination for Northern Natural Gas Company in 1969 which would approximate 30% of original cost?

"A. Well, I think possibly that that is putting in a fairly severe—

"Q. How would you put it?

"A. Well, I would say that it was just indicated that this would seem to be the better policy to follow, that is, to be guided by staying within the limits of or within the area of 30% of original cost and close to the prior year's appraisal.

. . .

"Mr. Adams: . . . What I meant to say and what I now say is that as I understand your testimony there is a directive, whether it be an understood directive, whether it be in a more physical nature which would require employees of the Property Valuation Department and particularly yourself in connection with the assessment of Northern Natural Gas Company to arrive at an assessment value of Northern Natural Gas Company's property in 1969 which would approximate 30% of original cost?

. . .

"A. Well, I am lost a little now. If I understand the last question I believe I would have to say that I don't—I don't recall that it was specifically stated that I actually was instructed to place the property of Northern Natural Gas Company specifically at 30% of original cost, but it was—it was—I can't think of the proper term really to specify it. It was the feeling that in the appraisal of all of these companies that we would adhere to the previous policy of—of maintaining our appraisals in their relationship to—in a uniform relationship to original cost and generally speaking it was and had been accepted that we would —that 30% of original cost was a good measurement to adhere to.

"Well, I'd dislike to say that it was—or accept that it was predetermined, but in view of the fact I guess it could be construed that way in view of the fact that there was a definite influence because there was a tendency, of course, not to deviate too far from 30% of the original cost or away from the benchmark.

"Q. Specifically, is this the reason why only 85% weight was given to the trended cost study?

"A. Well, I think that the answer to that would have to be yes in view—and I regret the fact actually that there was any arithmetic value given to either one of the indicators."

On cross examination by counsel for the Director Gillgannon testified:

"Q. Now, do you know exactly what the Director did with this return?

"A. Not exactly, no. I imagine that he perused it and decided on whether there should be any—

"Q. At that point he exercised his judgment?

"A. His judgment, yes.

"Q. And are you stating under oath that you were directed at any time, impliedly or otherwise, to pre-

determine a value of original cost and then work toward that value? Are you saying that you were directed by anyone to do that?

"A. Yes, it was. As a matter of fact, there was a meeting in the Director's office in which Mr. Jones and I were present—Mr. Rook (sic) was not present this particular day—and it was suggested that we not deviate notably from the previous year's appraisal.

"Q. You see, that is not what I am asking you. I am asking you if—let's make it even more specific, and I want this—a direct answer from you, yes or no. Has Mr. Dwyer at any time directed you to disregard other factors and to establish an original cost as a value of this company?

"A. The answer to that is no. That is—

"Q. Did Mr. Jones at any time direct you to disregard all other factors and to consider original cost only?

"A. No, Mr. Jones did not."

From a study of Gillgannon's testimony before the Board and a consideration of his testimony given by deposition, we cannot find the Board fraudulently predetermined that original cost was the value of Northern's property, and that the Board worked backward by giving only lip service to statutory factors.

The Director maintains that original cost less depreciation, asserted by Northern, should not be used to reflect market value for Kansas ad valorem tax purposes. For many years the Director and his predecessors declined to be governed solely by regulatory body rate base findings in determining justifiable or fair market value. Greater weight has been given to reproduction cost less depreciation rather than rate base. The appraisal practice used for many years in the Department of Property

Valuation by trending the original cost, which took into account both appreciation and depreciation as indicators to arrive at current market value on assessment date, brought the result in close proximity to the original cost figure in appraising public utilities, and as a result the original cost undepreciated had been considered a "bench mark." This does not mean the final determination of value is original cost undepreciated. The record is replete with exhibits proving that many indicators of value were used and correlated in making the determination.

A situation of this nature was discussed in *Nashville, C. & St. L. Ry.* v. *Browning*, 310 U.S. 362, 84 L.Ed. 1254, 60 S.Ct. 968, where it was said:

> ". . . Deeply embedded traditional ways of carrying out state policy, such as those of which petitioner complains, are often tougher and truer law than the dead words of the written text. . . . It is not the Fourteenth Amendment's function to uproot systems of taxation inseparable from the state's tradition of fiscal administration and ingrained in the habits of its people." (pp. 369, 370.)

We do not find the recognition of a "bench mark" by the Property Valuation Department in the appraisal of public utility property for ad valorem tax purposes, resulting from many years of experience, to be objectionable or unlawful. The "bench mark" was indicated by the state's Exhibit "C" introduced in evidence before the Board at its hearing on July 31, 1969, to show equalization and uniformity in the assessment of public utility properties similar to Northern's property.

Considering the circumstances under which the deposition testimony of Gillgannon was taken, its credence is subject to discount, if it be construed as reflecting arbitrary action on the part of the Director or the Board. The Director exercises independent judgment in approving the

valuation of property by personnel in his department, and the Board exercises its judgment anew and independent of the Director in approving the valuation and assessment of property. Whether the Board determines the matter of property valuation before it as an appeal board or as a board of equalization, it functions independently of the Director in matters of administrative judgment and decision. It is the order of the Board which is here for review.

The extent to which Gillgannon's deposition testimony may be construed as having departed from his testimony before the Board subjects the probative value of his deposition testimony to impairment.

Northern contends the Kansas Constitution has been violated (Art. 11, §1) by the Director's method of assessing Northern's property at 30% of original cost, which Northern claims is fraudulent and intentionally discriminatory because it unconstitutionally classifies Northern and other natural gas companies separately from all other taxpayers.

Northern's assertion on this point is premised upon its interpretation of Gillgannon's deposition that the Director assessed Northern's property at 30% of original cost. This assumption on Northern's part is found to be without merit and as a result its argument on the point fails.

Northern's property in accordance with the statutes heretofore cited was valued as real property, its justifiable value determined in accordance with the provisions of 79-503, *supra*, and it was assessed at 30% of its justifiable value. (K.S.A. 79-1439 [L. 1963, ch. 460, §1].) This is the basis upon which all nonexempt real property in the state of Kansas is valued and assessed. It makes for uniformity and equality in the rate of assessment and taxation.

Two gas pipeline utility companies, Natural Gas and Kansas-Nebraska Natural Gas Companies, were granted

a reduction in their assessments by the old Board of Tax Appeals before it went out of existence on July 1, 1969. (L. 1969, ch. 369.) These isolated orders reducing utility assessments do not disclose a failure on the part of the Board to equalize, where an honest effort has been made in determining valuations and assessments on a state-wide basis for public utilities in accordance with the statutory mandates. Evidence offered by Northern to show these reductions in assessment do not support its allegation that the new Board has been unreasonable, arbitrary and capricious because it did not give a similar reduction in assessment to Northern. Uniformity is maintained only by assessing property at 30% of its justifiable value in accordance with statutory mandates.

Northern contends that evidence of the local level of assessment in the various counties was improperly ignored. It argues that the Director's order purports to assess Northern's property at the rate of 30% of justifiable value. Northern asserts the evidence it adduced shows that all other real property in the various counties involved was being assessed at different and appreciably lower levels.

Beardmore v. *Ling*, 203 Kan. 802, 457 P.2d 117, is cited for the proposition that:

> "Uniformity in taxation implies equality in sharing the burden of taxation, and this equality cannot exist without uniformity in the basis of assessment as well as in the rate of taxation. . . ." (Syl. ¶ 2.)

There the court held that an assessment ratio study made pursuant to statute was admissible in evidence as tending to establish the assessment ratio of real estate, even though it was not conclusive on the subject.

Evidence presented before the Board consisted of the 1968 sales ratio study indicating the level of assessment on January 1, 1969, in those twenty-six counties in Kan-

sas where Northern's property is located. The Real Estate Assessment Ratio Study shows two counties with a ratio of only 10% (Meade and Kiowa), one at 15% (Seward), one at 17% (Finney), and one at 11% (Gray). All of these counties with the exception of Gray County have reappraised and new higher assessments were to be expected in 1969. Apparently, Lincoln County has also reappraised in 1969. The assessments occasioned by the reappraisal in these counties were not available when this matter was heard by the Board in July, 1969. The average ratio for all other counties in which Northern has property is slightly over 21%. The evidence consisted not only of the ratio study itself, but of the testimony of Dr. Francis Woodard responsible for the preparation of the study under the supervision of the Director. Northern then introduced exhibits showing not only the level of assessment in each county but also what the proper assessment in each county would be upon the basis of the appraisals made by its two expert appraisers. Needless to say, had the Board applied the formula asserted by Northern it would not have assessed Northern's property at 30% of justifiable value in each of the twenty-six counties. The rate of assessment in each of the twenty-six counties would have been different.

The Board found:

> ". . . The Ratio Study relates assessment levels with limited sales, but does not afford direct comparison with all elements included in justifiable value in accordance with K.S.A. 79-501 and 79-503, as amended, . . ."

The Board further found that Northern's property is not assessed relatively higher than other comparable property in Kansas.

The same point was presented to this court in *Panhandle Eastern Pipe Line Co.* v. *Dwyer*, 207 Kan. 417, 485 P.2d 149, involving the state-wide assessment of Panhandle's pipeline property in the state of Kansas. In that opinion, to which we adhere, this court said:

"We are forced to conclude that the ratio study standing alone is not conclusive as to value. In *Cities Service Oil Co.* v. *Murphy*, 202 Kan. 282, 447 P.2d 791, we held:

"'Ratio studies provided for by K.S.A. 79-1436 are proper evidence of justifiable value but such evidence, standing alone, is not conclusive in establishing a basis for comparison in determining uniformity of values for assessment purposes.' (See, also, *Beardmore* v. *Ling*, 203 Kan. 802, 457 P.2d 117.) It might also be suggested that the 1969 legislature passed a law (K.S.A. 79-503 [j]) not made applicable to this case, stating:

"'. . . The ratio study shall not be used as an appraisal for appraisal purposes.'

"It would at least indicate the legislature was not out of harmony with the decisions of this court.

"There are too many speculative elements involved and too few properties are subject to sale for the ratio study to be relied on for appraisal purposes. It may, however, serve as a signal that a reappraisal is in order." (p. 423.)

Northern Natural Gas Co. v. *Williams*, 208 Kan. ....., ... P.2d ....., discusses and considers the ratio study in more detail.

On the record here presented we hold Northern has not by the ratio study or the testimony of Dr. Woodard presented sufficient evidence of any quality to justify a reduction of its assessment in each of the various counties

where the ratio study purports to disclose an assessment at less than 30% of justifiable value.

Finally, Northern contends the order of the Board violates the Fourteenth Amendment to the United States Constitution on the ground that grossly excessive valuation of property for ad valorem tax purposes contravenes the due process clause, and requires no showing of discrimination. (Citing *Great Northern Ry.* v. *Weeks*, 297 U.S. 135, 80 L.Ed. 532, 56 S.Ct. 426.)

Northern asserts the right to equal treatment under the equal protection clause of the Fourteenth Amendment to the United States Constitution and Article 11, Section 1 of the Constitution of the state of Kansas.

The whole argument proceeds on the assumption that the valuation of its property was grossly excessive for ad valorem tax purposes. On this point, however, Northern has failed to sustain the burden of proof to show that its property has been valued excessively.

In conclusion we hold the order of the Board dated August 20, 1969, appealed from herein, was not unreasonable, arbitrary or capricious. The order was lawful in all respects and the Board applied the required statutory standards of value to Northern's Kansas operating property. The order was based upon and in accordance with the evidence before it. The validity of the order was not shaken by the deposition testimony of Gillgannon, which was taken after his services for the state were terminated, and after the hearing before the Board. A thorough review of the record discloses no evidence that the Board has acted under the influence of improper motive, or acted in an unreasonable, arbitrary or capricious manner. The variation in valuations presented in the record stems basically from the difference of opinion of the witnesses and

the contending parties to the litigation. The Board's action in the valuation and assessment of Northern's Kansas operating property falls well within the realm of administrative judgment.

The judgment of the lower court is affirmed.

This opinion was approved by O'CONNOR, J., prior to his resignation from the court.

PRAGER, J., not participating.

SCHROEDER, J., concurring: I agree fully with the foregoing opinion except for the consideration given by the court to the real estate assessment ratio study and the evidence pertaining thereto. On this point I concur only in the result—that is, that the trial court did not err in affirming the order of the State Board of Tax Appeals as to the valuation and assessment of Northern's property on a state-wide basis.

Inferentially, the court's recognition of the ratio study evidence and consideration of the question recognizes the validity of such issue where property is assessed on a state-wide basis by the Director of Property Valuation and on appeal by the State Board of Tax Appeals. With this proposition I cannot agree.

First, both the Director and the Board in the valuation and assessment of property on a state-wide basis were *required by statute* to assess Northern's properties *at 30% of justifiable value*. Recognition of the ratio study issue where an attempt is made to show a disparity in the assessment level of the various twenty-six counties involved could, upon a showing by satisfactory evidence, force a departure from the statute and recognize authority in the Board to assess at a lower percentage of justifiable value than the 30% required by statute. (K.S.A. 79-1439 [L. 1963, ch. 460, §1].)

Second, it could require the state to assess the portion of state assessed property attributable to a given county at a different percentage rate for each of the various twenty-six counties within the state in which Northern had property.

Third, none of the local county officers or assessing officials is a party to this action, and therefore, would not have an opportunity to defend the assessment levels in the various counties as being in compliance with the mandate to assess at 30% of justifiable value. Thus, the Board would not have jurisdiction over indispensable or necessary parties to issue an order of this nature.

Fourth, recognition of the issue is inconsistent with *Northern Natural Gas Co.* v. *Bender*, 208 Kan. ....., ... P.2d ..... The point here under consideration should be a corollary to the rule in *Bender;* that is, where the Kansas property of an interstate public utility is assessed by the State Director of Property Valuation on a state-wide basis, as authorized by K.S.A. 79-1404, *Fifteenth*, the Director of Property Valuation lacks jurisdiction to determine the assessment level of property in the various local counties involved, but is required to assess the property in accordance with the statutory mandate at 30% of justifiable value for the portion of the property which is attributable to each of the various counties. If discrimination exists at the local county level in the assessment of property, it should be resolved in a protest action under K.S.A. 79-2005 (now L. 1971, ch. 303, §1).

FATZER, C. J., concurring in part and dissenting in part: One of the important issues in this case, and in my judgment the decisive one, is the construction and application of K.S.A. 1970 Supp. 74-2426 (effective April 25, 1969), requiring the Board of Tax Appeals to make findings of fact upon which it bases its determination, and

grants the appellant the right to appeal to a district court of a county in which a portion of its property is located, from the final order of the Board approving the assessment of its property, where such order is unreasonable, arbitrary or capricious.

Following our decision in *Board of County Commissioners* v. *Brookover*, 198 Kan. 70, 422 P.2d 906, the Legislature in 1969, amended K.S.A. 74-2426. Prior to the amendment, the Board was not required to make written findings of fact, and no right of appeal existed from the Board's order approving an assessment of property for property tax purposes. The statute may be found as K.S.A. 1970 Supp. 74-2426 (since amended, see Ch. 249, L. 1971), and the additions made by the amendment are italicized in the pertinent portions, as follows:

> ". . . Whenever the board of tax appeals shall enter its final order on any appeal, said board *shall make written findings of the fact forming the basis of such determination and final order and such findings shall be made a part of such final order. Within ten* (10) *days after its decision the board* shall mail a copy of its order by registered or certified mail to the person, firm, corporation or association who was a party to such appeal. Within thirty (30) days after the mailing of the final order of the board, any party to such appeal may appeal to the district court of the proper county: *Provided*, That no such appeal may be taken to the district court from any other determining, approving, modifying or equalizing the assessment of property for property tax purposes *unless such order is unreasonable, arbitrary or capricious. . .*"

The words "unreasonable, arbitrary or capricious" as used in the statute have reference to an assessment of property

for property tax purposes that is illegal, or amount to constructive fraud, or the equivalent of fraud on the rights of a taxpayer.

Other pertinent portions of K.S.A. 1970 Supp. 74-2426 are quoted in the court's opinion and it would be repetitious, and unduly lengthen this opinion to requote them here. Reference is made in the court's opinion to numbers in brackets which were added to facilitate the discussion of the statute, and the bracketed numbers will be referred to in this discussion.

In amending the statute, it was the evident intent of the Legislature to require the Board of Tax Appeals to comply with basic principles of administrative law repeatedly stated by this court. It has been held that official boards, such as the Board of Tax Appeals, are required by this court to express their orders and decisions in formal and explicit findings to the end that review may be intelligent, *and where the Legislature has imposed a specific requirement that the basic facts conditioning action by administrative boards be stated in findings, such findings shall be stated explicitly.* And in default of such fulfillment, there is no official action—only a vain show of it, with the result that such orders are unlawful and must be set aside and held for naught. (*Southern Kansas Stage Lines Co.* v. *Public Service Comm.*, 135 Kan. 657, 11 P.2d 985; *Rock Island Motor Transit Co.* v. *State Corporation Comm.*, 169 Kan. 487, 219 P.2d 405; *City of McPherson* v. *State Corporation Commission*, 174 Kan. 407, 413, 257 P.2d 123; *Class I Rail Carriers* v. *State Corporation Commission*, 191 Kan. 201, 380 P.2d 396; *Kansas Public Service Co.* v. *State Corporation Commission*, 199 Kan. 736, 433 P.2d 572; *Cities Service Gas Co.* v. *State Corporation Commission*, 201 Kan. 223, 440 P.2d 660.)

In *Kansas Public Service Co.* v. *State Corporation Commission*, supra, this court said:

> ". . . An ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact. . . Such an ultimate finding is not enough, in the absence of basic findings to support it. This court must first know what the basic findings are before it can give them conclusive weight. We have repeatedly emphasized the need for clarity and completeness in basic or essential findings on which the administrative orders rest, and findings based on substantial evidence must embrace the basic findings which are needed to sustain the order. . ." (l.c. 743, 744.)

It was also said:

> "The reasons for requiring the findings of basic facts by an administrative agency are so powerful that the requirement has been imposed with undeviating uniformity by this court. The rationale of the rule as gleaned from the foregoing cases and others, is to facilitate judicial review, avoid judicial usurpation of administrative functions, assure more careful administrative consideration to protect against careless and arbitrary action, assist the parties in planning their cases for rehearing and judicial review, and keep such agencies within their jurisdiction as prescribed by the Legislature. . ." (l.c. 744.)

Under the clear and direct language of 74-2426, the Board of Tax Appeals is required to express the basic facts on which it relies with sufficient specificity to convey to the parties, as well as to the courts, an adequate statement of the facts which persuaded it to arrive at its determination. The findings must be expressed in lan-

guage sufficiently definite and certain to constitute a valid basis for the order, otherwise, the order cannot stand. When a decision is accompanied by findings of fact, the supreme court can determine whether the decision reached by the district court or the Board follows as a matter of law from the facts stated as its basis, and also whether the facts so stated have any substantial support in the evidence. In the absence of findings of fact, the reviewing district court, or this court on appeal, can determine neither of those things. The requirement of findings is, thus, far from a technicality. On the contrary, it is to insure against star-chamber methods of arbitrary, capricious, and unreasonable action, and to make certain that justice shall be administered according to fact and law. (*Kansas Public Service Co.* v. *State Corporation Commission*, supra.) More will be stated on this point when the findings of the Board's order of August 20, 1969, are set forth and discussed.

Generally speaking, I concur in the court's conclusion that when an appeal is perfected to a district court pursuant to the statute, the filing of the appeal constitutes the commencement of an original action, which shall be heard as an equity proceeding. (*Walkemeyer* v. *Stevens County Oil & Gas Co.*, 205 Kan. 486, 492, 470 P.2d 730.) The inherent issue is always: Is the assessment lawful and in conformity with K.S.A. 1968 Supp. 79-503 (since amended)? Likewise, I am in accord that the rules of evidence of the Code of Civil Procedure apply in the trial of such an action. Despite the fact the appeal is from an order of an administrative tribunal, the trial in the district court is *de novo*—in the sense the court may receive and consider any evidence relevant to the issues presented in the action, and is not limited to the evidence presented before the Board of Tax Appeals. This is so

because the statute expressly provides [9] that the transcript of proceedings had at the hearing before the Board of Tax Appeals *may* be admissible in evidence. In other words, the district court may hear and consider relevant oral testimony and other relevant evidence procured by discovery, deposition, or pursuant to other available proceedings authorized by the code. The power of a district court to receive and consider relevant evidence is provided for, but that power is not to be employed for the purpose of enlarging the scope of judicial review—the test being, the evidence must be relevant to the limited issues before the district court, namely, whether the order of the Board is "unreasonable, arbitrary, or capricious." But bound up in that phrase is the ultimate question whether the assessment of property for property tax purposes conforms to K.S.A. 1968 Supp. 79-503, that is, whether the assessment is legal, or results in invidious discrimination, which is characterized by our decisions as being constructively fraudulent.

The limitations upon the power of a district court to review by a trial *de novo* the decisions of an administrative body are stated in *Rydd* v. *State Board of Health,* 202 Kan. 721, 451 P.2d 239, as follows:

> "It is true the appeal statute here (65-504) provides for trial *de novo;* however, as in *Foote,* the statute is to be construed in the light of the constitutional inhibition prescribed by the separation of powers doctrine. This means the legislature may not impose upon the judiciary the function of a trial *de novo* of action of an administrative agency in the sense of authorizing the court to substitute its judgment for that of the administrative agency in matters other than law or essentially judicial matters.

> "65-504 authorizes the court to act if it finds the board's order arbitrary, unlawful or unreasonable. The issue, then, before the district court upon appeal is the reasonableness and legality of the order appealed from. . ." (l.c. 729.)

And it was further said:

> ". . . The lack of uniform requirements and resultant practice in recording evidence supporting administrative action, as well as the indiscriminate use of the term trial *de novo,* has contributed to some confusion in our law and points up the desirability of greater uniformity in our statutes governing hearings by administrative agencies and judicial review of their actions. This problem was recently discussed in *Bodine* v. *City of Overland Park,* 198 Kan. 371, 424 P.2d 513, where it was stated that evidence submitted upon judicial review of a zoning action was to be received in accord with our evidentiary code (K.S.A. chap. 60, Art. 4). The trial in district court then is *de novo* in the sense the court may take its own evidence and is not necessarily limited to the evidence presented before the administrative board. The power to receive and consider such evidence, however, is not to be employed for the purpose of enlarging the scope of judicial review—the test being, the evidence must be *relevant* to the limited issue before the court on appeal; namely, the reasonableness and legality of the order appealed from. . ." (l.c. 731, 732.)

The need for the Legislature to enact a uniform administrative procedures act to bring about consistency of judicial review of administrative orders and decisions, is once again strongly supported by this case, as well as other cases recently considered by this court.

The foregoing requires a concurrence with my colleagues' determination that the district court erred in failing to consider the testimony of Gillgannon submitted in his deposition. That evidence was clearly relevant and went directly to the main issue before the district court. The thrust of Gillgannon's testimony was that the Director of Property Valuation had preconceived the value of Northern's property, as well as the value of Panhandle Eastern's property (No. 46,257), and other similar public utilities, *by instructing the deponent to first compute Northern's justifiable value to reflect 30 percent of original cost, which directive was complied with as will be hereafter demonstrated by quoting from the record, and second, not to deviate substantially from the manner of assessments in prior years.* That gross misconduct by the Director, which was carried out by Gillgannon in practice and by his testimony before the Board of Tax Appeals certainly raised extrinsic issues that should be considered in an original equity proceeding as provided by K.S.A. 1970 Supp. 74-2426. This error was highly prejudicial, and standing alone should require a reversal of this case.

But the foregoing is the extent to which I can agree. In view of conclusion heretofore stated, I am of the opinion this case should be reversed with directions to the district court to remand the issues to the Board of Tax Appeals to carry out its mandatory duty to make essential basic findings of fact.

As indicated, the vice of this case is the order of the Board of Tax Appeals itself. The court did not set forth that order in its opinion and point out its deficiencies. However, the court frankly concedes the order violates the Board's statutory duty to make written findings. Except for a few immaterial statements, the Board's order approving Northern's assessment of property on August

20, 1969, was identical with its order approving the assessment of Panhandle Eastern (No. 46,257, see my dissenting opinion in that case), and other similar public utilities. The Board's order reads:

"BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

"SITTING AS THE STATE BOARD OF EQUALIZATION

"IN THE MATTER OF THE APPEAL OF NORTHERN NATURAL GAS COMPANY, FROM THE ORDER OF THE PROPERTY VALUATION DEPARTMENT DETERMINING THEIR ASSESSED VALUATION FOR THE YEAR 1969.	No. 2206-9

"ORDER

"Now, on this 31st day of July, 1969, the above matter comes on for hearing before the Board of Tax Appeals of the State of Kansas, sitting as the State Board of Equalization.

"The appellant appears by Mark Adams II, Counsel; Frank Duffy, Counsel; Larry Gipe, Counsel; K. R. Boyer, Manager, Tax Department; Dave Wortman, Tax Analyst; O. L. McQuin, Senior Tax Agent; Dr. Herbert Dorau, Consultant; Broley Travis, Consultant; Wm. Fields, Consultant; and Francis O. Woodward, Consultant. The Property Valuation Department appears by Clarence J. Malone, Chief Attorney; Ronald F. Dwyer, Director; and Mike Gillgannon, Appraiser.

"Thereupon, the matter proceeds to hearing and evidence is produced by the appellant and the Property Valuation Department of the State of Kansas, which matter is taken under advisement by the Board.

"And now, on this 20th day of August, 1969, after careful consideration of the evidence presented and arguments of Counsel, the Board makes the following findings:

"1. Northern Natural Gas is a Corporation engaged in transporting natural gas in interstate commerce with some subsidiary intrastate operations.

"2. Appellant is under jurisdiction of the Federal Power Commission for purpose of rate regulation. Intrastate Subsidiary Commission operations are under jurisdiction of Kansas State Corporation for the purpose of rate regulation within Kansas.

"3. The contention of the appellant that the sole basis of valuation for assessment of his property should be the value placed upon it by the State or Federal regulatory body establishing rates is in error.

"4. The Board has taken administrative notice of the Kansas Ratio Study for 1968. The Ratio Study relates assessment levels with limited sales, but does not afford direct comparison with all elements included in justifiable value in accordance with K.S.A. 79-501 & 79-503, as amended, which provides the statutory authority under which the Director of Property Valuation is required to assess state assessed properties.

"5. The Board finds that the taxpayer has failed to sustain the burden of proof that the values determined by the 1968 Ratio Study in the counties involved are supported by any substantial evidence.

"6. That we find no evidence of bad faith, arbitrary or oppressive action, or systematic discrimination and distinction made by the Director of Property Valuation between the subject utility and the assessment of other utilities similarly situated.

"7. In the absence of any evidence that the assessment was arrived at fraudulently, arbitrarily, or capriciously, and in the absence of any evidence of arbitrary discrimination between, or a lack of uniformity in, the valuation and assessment of all other utilities similarly situated, a difference of opinion as to value or an alleged error or mistake in judgment by the assessing officer is no ground for interference by the Board of Tax Appeals, sitting as the State Board of Equalization.

"8. The taxpayer has the burden of proof and has failed to sustain the burden of proof to establish by evidence that the assessment lacks uniformity.

"9. That said property is not assessed relatively higher than other comparable property in this state; the facts presented for the Board's consideration do not justify a reduction; the appeal should be denied and the valuation remain as assessed.

"IT IS, THEREFORE, BY THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS, SITTING AS THE STATE BOARD OF EQUALIZATION, ORDERED that the appeal be, and the same is hereby, denied.

"Dated at Topeka, Kansas, this 20th day of August, 1969."

The court concedes the Board utterly failed to comply with its statutory duty to make essential findings of

fact showing the basis of its determination, as stated in the majority opinion:

> "While the Board did make what was denominated written findings of fact, our analysis of its written findings discloses they are mere conclusions which fail to give the basis for its determination and final order. The findings should have been specific setting forth the factual basis for the Board's determination. . ."

The court's concession of the unlawfulness of the Board's order should automatically reverse this case with directions to the district court to remand the proceeding to the Board with instructions that it comply with K.S.A. 74-2426, and make explicit findings of fact showing the basis of its determination. However, and despite the foregoing concession, the court concludes that it does not regard the failure of the Board to make findings of fact fatal to further review. Its conclusion appears to be that the Board's approval of "the assessment of Northern's property by the Director thereby adopted the same justifiable value and assessment that had been made by the Director." The court apparently proceeds upon the assumption that it may infer or imply from the Board's order approving Northern's assessment that the factual basis upon which the order was entered may be ascertained. This is gross error.

This court has passed upon an almost identical procedural question in *Cities Service Gas Co.* v. *State Corporation Commission*, supra. There, the Commission issued an order directed to several intrastate natural gas pipe line companies operating within Kansas to show cause why they should not be required to obtain a certificate of convenience and necessity from the Commission, and

file rate tariffs on charges, and other matters. Following a hearing before the Commission, it issued its order asserting jurisdiction of the gas pipe line companies pursuant to its own Rule and Regulation No. 82-1-232 relating to proceedings before the Commission. The regulation described the form and content of orders to be issued by the Commission, which required it to make findings of fact, detailing all facts found by the Commission to be true, and to make conclusions of law based upon the facts as found. Upon appeal, the district court concluded as a matter of law that the order of the Commission was invalid and void for failure to make findings, and then, as here, searched the record and made its own extensive findings of fact and conclusions of law.

Upon judicial review of the district court's judgment, this court held the Commission's order failed to comply with its own regulations with respect to making findings of fact, and that the order likewise failed to comply with basic principles of administrative law repeatedly stated by this court. The case was reversed with instructions to the district court to set aside its findings of fact and conclusions of law, except its conclusion of law that the order of the Commission was invalid and void for failure to make adequate findings of fact, and directed the district court to remand the case to the Commission for further proceedings consistent with the opinion. In the opinion, this court said:

> "In the instant case, there were no basic findings of fact and there was nothing upon which the district court could review the evidence. In the absence of such findings, the district court was not called upon to examine the evidence in order to resolve opposing contentions as to what it showed or to spell out in its own findings of fact and state its conclusions of law

as the record might permit. The commission [Board] is the fact finding body, and the court examines the record not to make findings for the commission [Board] but to ascertain whether its findings are supported by substantial evidence. It need hardly be said the district court can neither affirm nor disaffirm findings which were never made. As we have seen, our statute and our decisions and the commission's rule demand that findings be made, and the courts and the parties are entitled to know how the commission disposes of the fact issues. Until that function has been performed, the courts cannot discharge theirs. We conclude the district court was not authorized under 66-118d to make findings of fact where no findings had been made by the commission, and in the absence of such findings, neither the district court nor this court on appeal can review them. Courts cannot perform the function assigned to them in the absence of adequate basic findings. (*Pacific Telephone & Telegraph Co.* v. *Flagg,* 189 Or. 370, 220 P.2d 522; *Valley & Siletz R.R. Co.* v. *Flagg,* 195 Or. 683, 247 P.2d 639.) In the latter case it was said:

"'*Pacific Telephone & Telegraph Co.* v. *Flagg,* supra, holds, not only that an order by the commissioner, unsupported by evidence, is invalid, but also that a court cannot write findings for the commissioner.' (l.c. 717.)" (l.c. pp. 234, 235.)

And it was further said:

"As noted, in the instant case there were no basic findings and there was nothing upon which the district court could review the evidence, and the order was void on its face. As stated in *Kansas Public Service Co.* v. *State Corporation Commission,* supra, courts

will not search the record to ascertain whether there is evidence from which an ultimate finding can be made. Under the circumstances, the district court should have found the order contained no basic findings and concluded as a matter of law it was void on its face, and transmitted its judgment to the commission." (l.c. 236.)

Under the authority of the *Cities Service Gas* case, the district court had a clear duty to declare the Board's order void for failure to make basic findings of fact and to remand the proceedings to the Board with directions to comply with its statutory duty. It is obvious from an examination of the Board's order there were no adequate findings made upon which it based a determination approving the Director's assessment of Northern's property for 1969. In the case of *Rydd* v. *State Board of Health*, supra, the point was decided, and we said:

". . . And we have indicated it would have been beyond the scope of the trial court's authority to make its own independent finding on the merits of appellee's fitness for a license. That function lay exclusively with the board. As the matter stood, the court could have made no conclusive order in favor of either of the litigants without substituting its judgment for that of the board. What course then could have been taken by the trial court other than to remand the proceeding for further hearing? We think none. . . In 2 Am.Jur.2d, Administrative Law, § 764, the rule is stated:

"'. . . the general rule is that even in the absence of statute, a court which sets aside an administrative determination has the power to remand the case to the administrative agency where such power is necessary to effectuate the demands of justice, and

statutes frequently grant such authority to the courts. The court does not encroach upon the administrative function of such procedure, and there is nothing in the principles governing judicial review of administrative acts which precludes the courts from giving an administrative agency an opportunity to meet objections to its order by correcting irregularities in procedure, or supplying deficiencies in its record, or making additional findings where these are necessary, or supplying findings validly made in the place of those attached as invalid.'

"The rule is further elaborated in the same work § 765, as follows:

"'The court must remand, or the administrative agency is entitled to have the proceeding returned to it, where the agency has taken action without meeting procedural requirements, has made invalid, inadequate, or incomplete findings. . . where judicial review discloses material errors but the reviewing court cannot enter a conclusive order. . .'

"The trial court properly remanded the proceeding."

Likewise, and in my judgment, the court's decision is directly contrary to established administrative law propounded by the court in a settled course of decisions. As indicated, the court apparently proceeds to examine the record to ascertain if the purported findings of the Board may be *implied or inferred* from its order. *This court has repeatedly held that where findings of fact are required as a matter of procedural law in order to support the administrative determination, the lack of express findings will not be supplied, implied, or inferred.* (*Class I Rail Carriers* v. *State Corporation Commission*, supra; *Kansas*

Public Service Co. v. *State Corporation Commission*, supra; *Cities Service Gas Co.* v. *State Corporation Commission*, supra.) Our decisions have cited *Atchison Ry.* v. *United States*, 295 U.S. 193, 79 L.Ed. 1382, 55 S.Ct. 748, and *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 9 L.Ed. 2d 207, 83 S.Ct. 239, and this court has adopted the following language from *Atchison Ry.*, and *Burlington*, respectively, which may be found in *Class I Rail Carriers*, supra:

> "'. . . Its report does not disclose the basic facts on which it made the challenged order. This court will not search the record to ascertain whether, by use of what there may be found, general and ambiguous statements in the report intended to serve as findings may by construction be given a meaning sufficiently definite and certain to constitute a valid basis for the order. In the absence of a finding of essential basic facts, the order cannot be sustained. *Florida* v. *United States*, 282 U.S. 194, 215. Recently this court has repelled the suggestion that lack of express finding by an administrative agency may be supplied by implication. *Panama Refining Co.* v. *Ryan*, 293 U.S. 388, 433. See *Beaumont, S.L. & W. Ryl.* v. *United States*, 282 U.S. 74, 86. *Interstate Commerce Comm'n* v. *Chicago B. & Q.R. Co.*, 186 U.S. 320, 341.'. (pp. 201, 202.)"

* * *

> "'. . . Expert discretion is the life blood of the administrative process, but "unless we make the requirements for administrative action strict and demanding, expertise, the strength of modern government, can become a monster which rules with no practical limits on its discretion." *New York* v. *United States*, 342 US 882, 884, 96 L ed 662, 663, 72 S.Ct.

152. . . The Commission must exercise its discretion under § 207 (a) within the bounds expressed by the standard of "public convenience and necessity." Compare id 346 US at 91. And for the courts to determine whether the agency *has* done so, it must "disclose the basis of its order" and "give clear indication that it has exercised the discretion with which Congress has empowered it." *Phelps Dodge Corp.* v. *NLRB*, 313 US 177, 197, 85 L ed 1271, 1284, 61 S.Ct. 845, 133 ALR 1317. The agency must make findings that support its decision, and those findings must be supported by substantial evidence. . . (pp. 215 and 216, 9 L.Ed. 2d.)'" (l.c. 208.)

Turning now to Gillgannon's deposition, the clear import of his testimony is that he was directed to predetermine a value of original cost. Then he was to manipulate his work sheets and place percentage weights upon certain valuation methods to achieve a result comparable to a 30 percent value of original cost. I am not prepared to say what effect that testimony might have upon the credibility of his evidence before the Board, or the viability of the Order of the Board; however, the lengthy quotation from the deposition as set out in the court's opinion necessitates additional quotation from the deposition to indicate the inference of preconceived valuation, and that the work product of Gillgannon was merely "frosting on the cake," so to speak. In his deposition he said:

"There was no documented directive in that respect but it was the policy of the Department to use this norm and Mr. Dwyer took the position that we shouldn't deviate from this norm and that we should not go too far afield in establishing appraisals notably different than the prior year unless this was justified

by new investment, increases in new plant. This position was made known to me more or less just in a conversation and I think that there was an understanding that this was the policy that would be followed. This conversation and this understanding took place prior to the appraisal period in 1969 but with reference to that period. This was more or less in casual conversation with regard to the policy that we would use. It was just indicated that this would seem to be the better policy to follow, that is, to be guided by staying within the limits of or within the area of 30% of original cost and close to the prior year's appraisal."

* * *

"Original cost is value of some sort. It has weaknesses of course. It may be construed to be a very reliable measurement of value at the inception of cost but as years go by original cost does tend to lose its merit in determining the value of the property because of economic factors of appreciation and depreciation which start to work on the property immediately."

* * *

". . . Thirty percent of original cost was a measurement that the Department fell into as being a test of uniformity and in an effort to see whether one company as related to another was—that there is a correlation between the relationship of the appraisal of one company with that of another and originally it was not intended to really represent justifiable value but it got established that way and it has been perpetuated as a reliable test of justifiable value.

"In the Director's determination of justifiable value of Northern's properties in the State of Kansas in 1969, if a greater weight had been given to the cost approach than 85%, this would have resulted in a higher justifiable value. That justifiable value then on an assessment basis would have exceeded the 30% or 30.34% ratio which currently appears in Column C of defendant's Exhibit 17, and this is the reason why no more weight was actually given to the trended cost than the 85%.

"A. Well, I'd dislike to say that it was—or accepted that it was predetermined, but in view of the fact I guess it could be construed that way in view of the fact that there was a definite influence because there was a tendency, of course, not to deviate too far from 30% of the original cost or away from the bench-mark.

"Q. (By Mr. Adams) Specifically, is this the reason why only 85% weight was given to the trended cost study?

"A. *Well, I think that the answer to that would have to be yes in view—and I regret the fact actually that there was any arithmetic value given to either one of the indicators.*" (Emphasis supplied.)

* * * *

"*I am stating under oath that I was directed to predetermine a value of original cost and then work toward that value.*" (Emphasis supplied.)

* * *

"Q. And are you stating under oath that you were directed at any time, impliedly or otherwise, to predetermine a value of original cost and then work toward that value? Are you saying that you were directed by anyone to do that?

"A. Yes, it was. As a matter of fact, there was a meeting in the Director's office in which Mr. Jones and I were present—Mr. Rook (sic) was not present this particular day—and it was suggested that we not deviate notably from the previous year's appraisal."

* * *

"Q. (By Mr. Carter) As a matter of fact if they had directed you to do that, you wouldn't have to have gone through the trouble of going through these different procedures and exercising your judgment as you have just testified to me that you did, would you?

"A. Well, this is true, but, of course, this is one appraisal practice over the years, that we were tied closely to the original cost as a benchmark.

"In my opinion, this is a weakness."

As previously indicated, I concur with my colleagues on the admissibility and relevance of Gillgannon's deposition as it relates to the issue of extrinsic fraud; however, I emphatically disagree that the questions raised in this case were submitted in the form of mere documentation which would authorize this court to resift the evidence, place probative value on the same, and render a judgment on the merits of that testimony.

This court had analogous situations before it on prior occasions. In *Boese* v. *Crane*, 182 Kan. 777, 324 P.2d 188, we stated:

"This court has recognized that under certain circumstances when the evidence is written, documentary in character, or in the form of depositions or transcripts its duty is to decide for itself what the facts establish, substantially as it would in an original case. (*In re Estate of Kemper*, 157 Kan. 727, 145 P.2d 103;

In re Estate of Besse, 163 Kan. 413, 183 P.2d 414; and *White* v. *Turner*, 164 Kan. 659, 192 P.2d 200.)

"The testimony of Mr. and Mrs. Dimsdale in the trial court was in the form of depositions. All other witnesses were present and testified in person. It is urged that this court apply the foregoing rule in reviewing the decision of the trial court, that is, to treat the case as if it were an original case. This rule, however, is not universally applied under all conditions. It has been applied where *all* the evidence is in written form (*White* v. *Turner*, supra); where the only oral testimony adduced has little, if any, bearing upon the principal question presented and all other evidence is in written form (*In re Estate of Kemper*, supra); but has not been applied to testimony written in form where the court would be called upon to disregard the testimony of one witness and accept as true the testimony of others (*Bolin* v. *Johnson County Nat'l Bank*, 160 Kan. 61, 159 P.2d 477 [deposition testimony]; *Karlan Furniture Co.* v. *Richardson*, 182 Kan. 756, 324 P.2d 180, No. 40,871, decided April 12, 1958 [stipulated testimony]; and see, also, *Akins* v. *Illinois Bankers Life Assurance Co.*, 166 Kan. 648, 203 P.2d 180).

"The circumstances in the present case do not call for an application of the rule urged by plaintiffs, where all of the evidence is in written form. The ordinary rule, giving credence where the trial court gave credence, as in *Tucker* v. *Hankey*, supra, and *Truck-Trailer Supply Co., Inc.* v. *Farmer*, supra, must control this decision. All of the plaintiffs' witnesses testified in person and all of the defendants' witnesses except Mr. and Mrs. Dimsdale testified in person. The deposition testimony of the Dimsdales was corrobo-

rated in many respects by one of the defendants' witnesses, and the testimony of the plaintiff, Otto Boese, insofar as the issue in this case is concerned, was contradictory to the plaintiffs' evidence. Should the rule propounded by plaintiffs apply, a reversal would require this court to give credence to the testimony of Otto Boese, when as a matter of fact it is apparent that the trial court rejected his testimony. The trial court had the opportunity to observe each of the witnesses who testified in person and familiarize himself with their demeanor on the witness stand, their interest in the controversy, and the greed and avarice manifested by each.

"Under these circumstances plaintiffs' specification that the trial court erred in believing the evidence contained in the depositions of Frank and Myrtle Dimsdale is without merit." (l.c. 779, 780.)

In *Karlan Furniture Co.* v. *Richardson*, 182 Kan. 756, 324 P.2d 180, we stated:

"In reaching the conclusions last above announced we have not overlooked contentions strenuously advanced by appellants to the effect that since the only evidence of record is in documentary form this court is required to decide for itself what the facts established, substantially in the same manner it would if this were an original case. We have so held. (*In re Estate of Kemper*, 157 Kan. 727, 145 P.2d 103, and earlier cases therein cited; *In re Estate of Besse*, 163 Kan. 413, 183 P.2d 414; *White* v. *Turner*, 164 Kan. 659, 192 P.2d 200.) It must be remembered, however, such rule is subject to some elasticity under certain conditions. In that connection we have pointed out that even though we determine the facts from the printed page we cannot disregard the testimony of one witness and accept as true the testimony of others

but, under such circumstances, should follow the ordinary rule, giving credence where the trial court gave credence, unless its findings of fact are illogical, improbable and unwarranted. See, e.g., *Akins* v. *Illinois Bankers Life Assurance Co.*, 166 Kan. 648, 655, 203 P.2d 180." (l.c. 760.)

See, also, *In re Estate of Bernatzki*, 204 Kan. 131, 460 P.2d 527.

The Board is the trier of facts in this case just as the district court was the trier of facts in the Boese and Karlan Furniture Co. cases. A substantial portion of the evidence presented at the administrative hearing of this matter was garnered from the witness stand. The Board, as the trier and finder of facts, is required to assess the demeanor of witnesses and determine whose testimony is to be believed. It is apparent to me from the record that the district court which erroneously failed to consider the Gillgannon deposition, should direct the Board to consider that testimony, weigh its credibility and materiality, and then render its judgment after due consideration of that testimony. The position taken by the court's opinion is clearly inconsistent with precedent, and the facts in this case do not compel a contrary result. We should not preempt the Board and substitute our opinion as to the relative probative force of Gillgannon's deposition. That is not the business of this court in reviewing orders of an administrative board, and I am loath to believe the court intends to incur such prodigious responsibilities *in futuro*. A conclusion otherwise would be giving credence to an argument that this court now intends to go into the assessment business and weigh the probative force of that evidence, a function heretofore reserved exclusively for an administrative board. The district court, upon the proffering of Gillgannon's deposition should have remanded the issues to the Board for a proper consideration

of his testimony. In light of the oral testimony contained in the record, that error clearly compels a reversal of this case.

In *Garvey Grain, Inc. v. MacDonald,* 203 Kan. 1, 453 P.2d 59, we held that an assessment, made in adherence to an assessment schedule promulgated by the Property Valuation Department which failed to consider pertinent statutory factors prescribed by the Legislature in K.S.A. 79-503 will not be upheld by this court. In this case, as in *Garvey,* the statutory factors have been lost sight of or willfully abandoned, and the mere assertion by the Director, or his official who made the assessment, that he *considered* all pertinent factors will not mitigate the admitted facts supplied from his own lips that he did not do so.

The statewide assessment of a public utility is a momentous task. However, since the enactment of K.S.A. 79-503 in 1963, and its subsequent amendments, including K.S.A. 1971 Supp. 79-5a04, effective January 1, 1971, the traditional ways of carrying out the state policy of assessing public utilities have been cast aside. By adopting the rationale of the majority opinion, this court has now entered into the era of the "bench mark" syndrome. For property taxation purposes, the Director is now permitted to consider as one of the factors of K.S.A. 1968 Supp. 79-503, a judicial fiction known as the "bench mark" declared synonymous with original undepreciated cost. As I understand the thrust of the court's opinion, it appears that the Director may now disregard all factors in 79-503 and use the original cost from the prior year, add additional physical outlay of a gas pipe line company for the current tax year, declare that value to be "justifiable," and be in harmony with the majority in this case.

This dissent has grown too long. Much more could be said and possibly should be, but other pressing matters require that it be concluded.

APPENDIX E

ORDER OF THE KANSAS DIRECTOR OF PROPERTY VALUATION

PROPERTY VALUATION DEPARTMENT OF THE STATE OF KANSAS

ASSESSMENT OF THE PANHANDLE EASTERN PIPE LINE COMPANY OF KANSAS CITY, MISSOURI.	Docket No. PL-357

ORDER

(Filed May 28, 1969)

Now, on this 27th day of May, 1969, the matter of the assessment of Panhandle Eastern Pipe Line Company of Kansas City, Missouri, comes on for hearing. The taxpayer appears by A. L. Fordemwalt.

The Director, upon hearing the evidence submitted took the matter under advisement.

And now, on this 28th day of May, 1969, after considering the evidence and exhibits of the taxpayer, together with the records and studies of the Property Valuation Department, the assessed valuation of the tangible property of the Panhandle Eastern Pipe Line Company of Kansas City, Missouri, situated in the State of Kansas for the year 1969 is determined at the sum of $56,078,497.00; and the intangibles tax is determined to be none.

Dated at Topeka, Kansas, this 28th day of May, 1969.

/s/ Ronald F. Dwyer
Ronald F. Dwyer, Director

APPENDIX F

ORDER OF THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

SITTING AS THE STATE BOARD OF EQUALIZATION

IN THE MATTER OF THE APPEAL OF PANHANDLE EASTERN PIPE LINE COMPANY FROM THE ORDER OF THE PROPERTY VALUATION DEPARTMENT DETERMINING THEIR ASSESSED VALUATION FOR THE YEAR 1969.	No. 2342-9

ORDER

(Filed August 20, 1969)

Now, on this 1st day of August, 1969, the above matter comes on for hearing before the Board of Tax Appeals of the State of Kansas, sitting as the State Board of Equalization.

The appellant appears by John Seeber, Attorney; C. A. Conoley, Attorney; Francis Woodard, Professor; John Green, M.A.E./S.R.A., and Andy Fordemwalt, Tax Supervisor. The Property Valuation Department appears by Mike Gillgannon, Appraiser; Ronald F. Dwyer, Director; and Clarence J. Malone, Chief Attorney.

Thereupon the matter proceeds to hearing and evidence is produced by the appellant and the Property Valuation Department of the State of Kansas, after which the matter is taken under advisement by the Board.

And now, on this 20th day of August, 1969, after careful consideration of the evidence presented and arguments of counsel, the Board makes the following findings:

1. The contention of Panhandle Eastern Pipe Line Company that the sole basis of valuation for assessment of his property should be the value placed upon it by the State or Federal regulatory body establishing rates is in error.

2. The Board has taken administrative notice of the Kansas Ratio Study for 1968. The Ratio Study relates assessment levels with limited sales, but does not afford direct comparison with all elements included in justifiable value in accordance with K.S.A. 79-501 and 79-503, as amended, which provides the statutory authority under which the Director of Property Valuation is required to assess state assessed properties.

3. The Board finds that the taxpayer has failed to sustain the burden of proof that the values determined by the 1968 Ratio Study in the counties involved are supported by any substantial evidence.

4. We find no evidence of bad faith, arbitrary or oppressive action, or systematic discrimination and distinction made by the Director of Property Valuation between the subject utility and the assessment of other utilities similarly situated.

5. In the absence of any evidence that the assessment was arrived at fraudulently, arbitrarily, or capriciously, and in the absence of any evidence of arbitrary discrimination between, or a lack of uniformity in, the valuation and assessment of all other utilities similarly situated, a difference of opinion as to value or an alleged error or mistake in judgment by the assessing officer is no ground for

interference by the Board of Tax Appeals, sitting as the State Board of Equalization.

6. The taxpayer has the burden of proof and has failed to sustain the burden of proof to establish by evidence that the assessment lacks uniformity.

7. Said property is not assessed relatively higher than other comparable property in this state; the facts presented for the Board's consideration do not justify a reduction; the appeal should be denied and the valuation remain as assessed.

IT IS, THEREFORE, BY THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS, SITTING AS THE STATE BOARD OF EQUALIZATION, ORDERED that the appeal be, and the same is hereby, denied.

Dated at Topeka, Kansas, this 20th day of August, 1969.

Charles B. Joseph
Chairman
Ralph McCarty
Member
Eugene E. Lee
Member
William D. Anderson, Jr.
Member

John E. Royston
Attorney & Secretary

APPENDIX G

MEMORANDUM DECISION OF THE DISTRICT COURT OF JOHNSON COUNTY, KANSAS

IN THE DISTRICT COURT OF JOHNSON COUNTY, KANSAS

Docket No. 44727

PANHANDLE EASTERN PIPELINE COMPANY, A. Corporation, Plaintiff,

vs.

RONALD F. DWYER, DIRECTOR OF PROPERTY VALUATION DEPARTMENT OF THE STATE OF KANSAS, et al, Defendants.

MEMORANDUM DECISION

(Filed May 20, 1970)

Now on this 19th day of December, 1969, the above matter came on for final hearing before the Court on plaintiff's appeal herein. Plaintiff or Appellant appeared by its attorneys of record.

The defendant, Ronald F. Dwyer, Director of Property Valuation Department of the State of Kansas, appeared by his attorney, Clarence Malone. There are no other appearances. The remaining defendants have filed an answer herein, but have taken no active participation and have adopted all defenses and contentions to be taken or made by the defendant Director. The pre-trial order filed herein so provided and in accordance therewith, the attorney for the remaining defendants as shown by affidavit filed of plaintiff's attorney was duly notified of the contents of said order and has made no objection thereto, and as a re-

sult thereof and in accordance with the pre-trial, all remaining defendants are bound by the pre-trial order, and by the evidence and contentions presented for all defendants by the Director's attorney. The said pre-trial order is hereby incorporated by reference.

Thereupon, this matter proceeds to hearing on the evidence introduced by the parties. The Court thereupon heard the arguments of the parties. Plaintiff's Exhibits numbered 1 through 14, and defendant's Exhibits marked A through G are admitted, and considered by the Court; all objections as to relevancy and materiality are overruled. The Court has considered the briefs of the parties and after consideration of all evidence and briefs and arguments of counsel, states issues and makes findings of fact and conclusions of law.

THE ISSUES

The Board of Tax Appeals in its order made specific written findings and it is mainly with findings No. 1 and No. 2 of that order that this appeal is concerned. The evidence, contentions, and arguments before this Court on appeal are the same as presented to the Board of Tax Appeals. The appellant prevailed upon the Board of Tax Appeals to use the Federal Power Commission Rate Base for the purpose of determining valuation for ad valorem tax assessment. Also, appellant undertook to prove to the Board of Tax Appeals that the ratio study for 1968 indicated an assessment of locally assessed real property at less than 30%. Appellant asked the Board of Tax Appeals to reduce the appellant's assessment to conform with the real estate ratio study in each county.

On this appeal on both of these points the same relief is requested of the Court.

Appellant contends that assessing authorities have ignored the unrefuted evidence, and failed to apply applicable factors as required by statute and case law. Three remedies are available to such a plaintiff: (1) an action for injunction under K.S.A. 60-907, to prevent the collection of an illegal tax; (2) the present action under K.S.A. 74-2426 (Chapter 368 of the Laws of Kansas of 1969) to appeal from an order of the Board of Tax Appeals allegedly unreasonable, arbitrary or capricious; and (3) paying under protest and seeking refund pursuant to K.S.A. 79-2005 as has been done by this plaintiff-appellant in Case No. 45474 now pending in this judicial district.

The Court is particularly concerned about the real estate ratio studies and the apparent percentage of assessed value to justifiable value. The constitutional mandate is clear, while the performance of assessors through the years may be less than adequate. Court decisions in this area are difficult to integrate due to the factors of state appraisal, county appraisal, and county appraisal from the use of state schedules being applied to real property and tangible personal property within various counties, particularly in the case of public utilities that operate in a number of counties, and the application of the various remedies above mentioned to these combinations of tax problems.

The general reliability of ratio study results appears to depend largely on the integrity of the speculator who is willing or unwilling to admit a proposed changed use of property. In the case of state assessed property one wonders if the sales for the ratio study were or were not within the area of a county where the utility owned property was located. Further, ratio studies lag behind assessments in point of time.

Inasmuch as ratio studies apply to real property only, while ad valorem mill levies tax the real property and the tangible personal property in a taxing district, as well as the state assessed property which is mixed in character, it appears that if ratio study numbers were accepted as gospel truth, they still would not equate to utility values.

A Court decision in the matter of a taxpayer under protest seeking a refund is somewhat different than an appeal from a board of equalization in that the jurisdiction of the court is the same as the Board of Tax Appeals acting as a Board of Equalization, and to enter an order adjusting a utility assessment would be unequal as to other utilities that were previously equally assessed as a class. In a case such as this, the taxpayer is not entitled to a trial de novo, and the trial is on the record with the Court having the jurisdiction of the Board of Tax Appeals sitting as a Board of Equalization.

The major difficulty in the present matter before the Court is that appellant purports to use the Garvey case (Garvey Grain, Inc. v. MacDonald, 203 Kan. 1) in precisely the manner suggested by Justice Schroeder to open the proverbial pandora's box, translating ad valorem to income tax and placing income producing property in a constantly unpredictable state.

Another vexing aspect of this litigation relates to the statutory change of the Board of Tax Appeals from a three member board to a five member board on June 30, 1969, with the old board in an order dated June 19, 1969, and certified June 27, 1969, substantially reducing the assessment of the Property Valuation Department for the taxpayer Natural Gas Pipeline Company of America; the Board was sitting as the State Board of Equalization, and the basis of the reduction was the limit and control of earnings of that taxpayer by virtue of the identical Federal

Power Commission regulations that apply to Panhandle Eastern Pipeline Company. Without for the moment considering whether the old board was correct under Garvey, or whether the new board was correct in not assessing primarily with reference to the Federal Power Commission regulations, it is obvious that the combined efforts of the old and new boards did not equalize assessments.

Defendant's Exhibits A and B indicate appellant enjoyed an increase in net operating income of over 35% since 1964, but that inflationary factors make income a less reliable measure of value. Exhibit A shows that low price levels for natural gas as set by the Federal Power Commission have created a situation where reserves are inadequate for future needs of new customers. Cases are pending before the F.P.C. to change pricing policy which should lead to long term reserve development. Appellant contends that "If there is a continuation of the present inflationary trend, periodic and frequent rate filings would appear to be necessary." When a pipeline is kept from going heavily into debt the leveraging of earnings decreases and construction of new facilities slows down. Inordinately high interest rates, lack of gas reserves and inflation have lowered the capital expenditure rate of appellant. Appellant hopes to cause the F.P.C. to recognize that the allowed rate of return must exceed the current cost of capital.

In view of the holding of this Court it is not necessary to determine whether the Court would have to refer this matter back to the Board of Tax Appeals for reconsideration in the event plaintiff sustained its position, or whether the Court has the power to set the assessments as requested, and in the event the Court could set the assessments in the respective counties how the county totals could be prorated between the sub-taxing districts within a county.

Some of the key questions in this litigation seem to be:

Has appellant's property in Kansas been assessed as of January 1, 1969 at an improper justifiable value?

If so, is such assessment arbitrary, unreasonable or capricious?

Have all of the statutory factors of K.S.A. 79-503 been properly considered in determining appellant's 1969 assessment?

If there is an over valuation, is it an unlawful valuation?

What relief does the Court have jurisdiction to grant?

What is the importance of F.P.C. regulations in determining justifiable value of a segment of a natural gas pipeline?

What is the importance, relevance, and reliability of ratio study information?

Is plaintiff's property evenly valued with all property of a class?

Is plaintiff's property evenly valued with the property in each county where it operates?

Is plaintiff's property evenly valued with all property in the state?

Does depreciated replacement cost have any relevance in valuing a natural gas pipeline subject to F.P.C. regulations?

Is there any relationship between rate base value and fair market value?

Is there a residual value of a fully depreciated public utility?

What is the meaning of the Garvey case?

Is the Director of Property Valuation a necessary or proper party to an appeal pursuant to Chapter 368, Session Laws of Kansas for 1969?

Can the present valuation of appellant's property stand as proper under the Kansas Constitution, Kansas Statutes, and Kansas Supreme Court decisions?

Should F.P.C. controls be considered in assessing a natural gas pipeline under one or more of the following headings: depreciation, functional obsolescence, economic obsolescence, social obsolescence, productivity, sale value on open market, such other elements as may be just and proper or not at all?

Is a 5% cap rate reasonable? Was Great Lakes to Williams Brothers a comparable sale? What would be the criteria of a prudent investor in purchasing a regulated public utility?

Does original cost trended to present reproduction value and then depreciated tend to result in a current dollar value which is near to original cost?

Was the order of the Board of Tax Appeals either: (1) unreasonable, arbitrary and capricious, or (2) unreasonable, arbitrary or capricious?

Did the Director of Revenue give testimonial lip service to the standards set forth in K.S.A. 79-503 or did he consider them all and in particular those that relate to F.P.C. regulations as reflected in the following testimony:

"Q. (By Mr. Seeber) Now, is it correct, Mr. Gillgannon, that this rate base figure of the Federal Power Commission, which controls the earnings and income, and the productivity of this company by limiting its earnings to this ceiling of six and five-eighths

percent on original cost less depreciation figure, was not used, or applied by you in arriving at your appraisal, and was given no weight by you whatsoever?
A. It would be true that it was given no mathematical weight, but it was considered. It was reviewed.
Q. You did not apply it, or use it in arriving at your value?
A. I used it.
Q. You didn't bring any figure down to that, did you, sir?
A. In the appraisal process, there are many figures that you don't bring down to a specific formula, but you do refer to them.
Q. In other words, you thought of it, but you did not apply it, and, actually adjust your figure because of it?
A. The term 'apply' is pretty hard to define in this sense, because you can apply it without showing it as additions, or multiplication, but it does have an effect.
Q. Well, when the final figure ends up, obviously, here, the original cost is $186,000,000, this figure, it's rather obvious, is it not, that this $123,000,000 figure was not used, or applied in arriving at the $186,000,000?
A. I would say it is obvious it wasn't given as much weight.
Q. It was given no weight, is that correct?
A. No."

FINDINGS AND CONCLUSIONS

1. The motion to dismiss previously filed by the Director is overruled.

2. The facts admitted by the defendants in their answer and in the pre-trial order referred to above are hereby incorporated by reference.

3. Appellant is a Delaware corporation, having its principal operating office at 3444 Broadway, Kansas City, Missouri 64141, and is authorized to do business in the State of Kansas. Appellee and defendant Ronald F. Dwyer (herein call "Director") is the duly appointed, qualified and acting director of property valuation of the State of Kansas, with official offices in the State Office Building, Topeka, Kansas. Appellees and defendants Charles B. Joseph, Ralph McCarty, Eugene E. Lee and William D. Anderson, Jr., are the duly appointed, qualified and acting members of the State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas under the provisions of Chapter 368 of the Laws of Kansas, 1969, and as such constitute and comprise said Boards; and defendant appellee John E. Royston is the attorney and secretary for the State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas. Said Boards and their secretary and attorney have their offices in the State Office Building in Topeka, Kansas. The State Board of Tax Appeals of Kansas and the State Board of Equalization of Kansas and its members, and its secretary and attorney will be herein referred to as "Board."

4. Appellant, a public utility corporation, owns and operates an interstate natural gas pipeline system extending from the States of Texas, Oklahoma, and Kansas, into the State of Michigan; it is engaged in the transportation and sale of natural gas in interstate commerce for resale

for ultimate public consumption and for domestic, industrial, and other uses; and it is a "natural gas company" as that term is used in the Natural Gas Act (15 U.S.C., Section 717 *et seq.*); and, as such, its earnings from ownership and operation of its pipeline system are regulated by the Federal Power Commission. Its property and facilities are located in Kansas and seven other states. It has no storage in Kansas. Its sales of natural gas in Kansas are 1.5% of its total sales. Its principal sales are in the Indianapolis, Toledo, and Detroit metropolitan areas.

5. The portion of Appellant's natural gas pipeline system located in the State of Kansas extends from the southwestern part of the state in a northeasterly direction, transversing among other counties, Johnson County, Kansas. The system is comprised of pipelines, compressors, and related facilities, all of which are utilized in operation of appellant's natural gas transportation system. Said properties are assessable for ad valorem tax purposes by the Director of Property Valuation pursuant to K.S.A. Chapter 79, Article 7.

6. Appellant duly made and filed with the Director of Property Valuation, on statements and schedules prescribed by the Director, a report showing a "Return Value" on $30,967,805 for 1969. The Director, by an Order dated May 28, 1969, assessed appellant's tangible properties in the State of Kansas for 1969 in the sum of $56,078,497.00.

7. Appellant timely appealed the Director's Order of May 28, 1969, to the Board pursuant to K.S.A. 74-2438 from the findings, rulings, orders, decisions, and other final action of the Director by filing its appeal before said Board June 27, 1969. On August 1, 1969, said Board heard all evidence by appellant and the Director on said appeal

to the Board, which hearing was recorded by a court reporter, and a transcript made thereof. Said Board by its order No. 2342-9 issued August 20, 1969, and mailed August 22, 1969, entered its final order denying appellant's appeal to the Board. The appellant is appealing herein the order of said Board as being unreasonable, arbitrary or capricious, and seeks relief therefrom under the provisions of Chapter 368 of the Laws of Kansas of 1969, effective April 25, 1969.

8. Appellant's property being assessed for ad valorem tax purposes in 1969 is located in the following 26 counties in the State of Kansas:

Anderson	Johnson
Barber	Kingman
Butler	Kiowa
Chase	Lyon
Clark	Marion
Coffey	Meade
Edwards	Miami
Ford	Morton
Franklin	Pratt
Grant	Reno
Harper	Seward
Harvey	Stafford
Haskell	Stevens

9. Plaintiff is and has been under the jurisdiction of the Federal Power Commission called "FPC" herein. The F.P.C. at this time controls and limits earnings plaintiff is permitted to make by limiting plaintiff to a rate of return (presently 6 5/8%) on the original cost of its property less depreciation. If plaintiff's earnings should exceed 6 5/8% of original cost less depreciation, it must refund the excess to its customers. In this manner a ceiling is currently

set on the earnings plaintiff can make and retain. Any buyer of plaintiff's property would also be limited by current F.P.C. regulation to the same earnings base and rate as plaintiff now has. Any excess paid by a buyer above the F.P.C. rate base might be lost by the buyer, with the buyer not able to recover the excess paid over the rate base. It is of course speculative to ponder the future of the F.P.C. and its regulations. The F.P.C. requires depreciation to be taken at the rate of 3 1/2% per year by plaintiff on its property in Kansas, and the rate base on which plaintiff is permitted to earn money by the F.P.C. is reduced each year by additional mandatory depreciation (except for net adjustments made to increase book cost [original cost less depreciation] for a result of replacements of items that are part of this system or for new construction). All figures relating to the original cost and depreciation of plaintiff's entire system used by both parties have as their basic source plaintiff's annual report filed with the F.P.C.

10. The total original cost shown by the State Board of Tax Appeals of Kansas and State Board of Equalization of Kansas and its individual members herein collectively called "Board" for Kansas was $186,928,324. The value of $186,928,324 and ad valorem tax assessment of 30% thereof or $56,078,497 by the Board, properly reflects the justifiable value and assessed value of appellant's property. The fact that plaintiff on the valuation date could only earn 6 5/8% per annum on an amount equal to the original cost of its property less accrued depreciation under the F.P.C. regulations ($123,523,501 by the Director's figures), was considered and applied by the Board in its order or actual determination of justifiable value, but it was given no mathematical weight. All factors specified by K.S.A. 79-503 for determining of justifiable value were considered by the assessing authorities.

11. The use by the Board of a 5% capitalization rate was a matter of judgment and not unlawful.

12. The factor of F.P.C. control on the income earnings of the appellant (F.P.C. rate base of original cost less accrued depreciation) was considered as an element of the Board's valuation and appraisal.

13. The system market value approach or unit method is best suited for valuation of plaintiff's property for its entire system and an allocation made on the percentage of the original cost in Kansas bears to the original cost of the entire system, and the correct Kansas allocation percentage is 29.47%.

14. The market approach and net stock and debt approach to value were not used or applied by either party, and should not be used or applied in this matter, and was not pertinent under the evidence before the Board.

15. This is a review of an order of the Board of Tax Appeals which involves not only the assessment of the appellant's property for taxation but also the question of equalization of that assessment, and it is the performance of a highly technical administrative function.

16. Under K.S.A. 79-709, after the completion of an assessment it must be apportioned not only to the several counties but to the townships, cities, school districts and other taxing districts which is determined by a formula which apportions to each taxing district that part of the total assessment as is proportionate to the total length of lines within the taxing district. The District Court should not undertake to "substitute its judgment" for the determinations of the Director of Property Valuation and the findings of the Board of Tax Appeals, or to impose a method of distribution which is incomplete under statutory requirements.

17. The Court further finds that the order of the Board of August 20, 1969, appealed from herein, with respect to plaintiff, was not unreasonable, was not arbitrary, and was not capricious. Said order was lawful and applied required statutory standards of value to plaintiff's property. The order was also reasonable and not arbitrary or capricious in all respects, and in accordance with the evidence before it. There was ample evidence to support said order and findings of and by the Board.

18. There is no evidence that the Board of Tax Appeals has been guilty of doing acts under the influence of a corrupt motive, or acted with unreasonable, arbitrary or capricious conduct; and therefore the administrative decision should be upheld by this Court.

19. The record indicates only a difference of opinion as to the amount of assessment and there is nothing in the record to justify a conclusion by the Court upon review that the Board of Tax Appeals in this case has not exercised good faith and rendered an opinion honestly formed.

20. The constitution and statutes of this state make provisions for uniform and equal rates of assessment and taxation of property.

21. The provisions of K.S.A. 79-503 require uniformity and equality in the mode of assessment of all real or tangible personal property in the state and were designed to benefit and protect the individual taxpayer from a sacrifice of his property by a disregard of its provisions in which his rights might be injuriously affected.

22. All real property or tangible personal property in every taxing district should be uniform and equally assessed at 30% of its justifiable value in money.

23. The factors or combinations thereof to be considered by taxing officials in determining justifiable value

are mandatory in assessing real property or tangible personal property, and they require consideration of the pertinent factors to specific property and an assessment of specific property in conformity with the provisions of K.S.A. 79-503.

24. In determining the validity of an assessment of real property or tangible personal property for taxation, the essential question is whether the standards prescribed in K.S.A. 79-503, declaring the manner of uniformity and equality in the distribution of the burdens of taxation, have been considered and applied by taxing officials, or intentionally and grossly disregarded.

25. Good faith alone on the part of taxing officials will not justify assessments which are in fact discriminatory.

26. State tax officials whose determinations are being reviewed, may not be questioned as to the precise factual basis of their findings or conclusions, or the precise factual details which influenced their findings and conclusions.

27. Uniformity in taxation implies equality in sharing the burden of taxation, and this equality cannot exist without uniformity in the basis of assessment as well as the rate of taxation.

28. Uniformity of taxation does not permit a systematic, arbitrary or intentional valuation of the property of one or a few or many taxpayers at a substantially higher or lower valuation than that placed on other property within the same taxing district.

29. Where it is impossible to secure both actual value assessment and uniformity in assessment, the constitutional and statutory requirements of uniformity must prevail. Assessments should be uniform state-wide and within

counties, and uniformity should exist within and between property classifications.

30. Ratio studies provided for by K.S.A. 79-1436 are proper evidence of justifiable value, but such evidence standing alone, is not conclusive in establishing a basis for comparison in determining uniformity of values for assessment purposes.

31. An assessment ratio study made pursuant to statute is admissible in evidence as tending to establish the assessment ratios of real estate even though it is not conclusive on that subject.

32. Pursuant to K.S.A. 79-1413(a) any property taxpayer may complain to the State Board of Tax Appeals and obtain a summary proceeding to be had on the question of an order issuing that there be a reappraisal of properties in such county.

33. The ad valorem tax law of this state is not an indirect form of income tax, and the valuation of income producing property for ad valorem tax purposes is governed by the totality of the factors enumerated in K.S.A. 79-503. F.P.C. regulation and control does not constitute functional, economic or social obsolescence, and if such government control were considered under these headings, they would still be but factors to be considered in determining justifiable value: agency control of rates and depreciation would best be considered by appraisal authorities under the statutory factor "and such other elements as may be just and proper."

(It should be noted that this last mentioned factor is not included in the present law, K.S.A. 79-503, having been amended by Chapter 433 of the Session Laws of 1969, and that a new Article 5a of Chapter 79 provides a method for assessment of public utilities. In deter-

mining values for January 1, 1969, the quoted language did apply.)

34. The rate base of the F.P.C. or any other regulatory body is not named in K.S.A. 79-503 as one of the factors to be considered.

35. Generally, the only function of a court in matters of assessment is to make certain that a taxpayer has the benefit of the honest judgment of the assessing officers and unless the assessment is proven to be so out of proportion as to give reasonable assurance that the officers could not have been honest in fixing its valuation interference by courts is not justified.

36. In the taxing process the assessment and valuation of property are administrative in their character and not judicial, and courts will not substitute their judgment for that of the assessing authority in the absence of fraud, or conduct so oppressive, arbitrary or capricious as to amount to fraud.

37. The order of the Board of Tax Appeals sitting as the State Board of Equalization concerning Panhandle Eastern Pipeline Company in its appeal from the order of the Property Valuation Department determining assessed valuation for the year 1969, is approved, adopted and incorporated herein by reference as a part of this memorandum decision.

The above and foregoing opinion is intended by the Court to incorporate necessary findings of fact and conclusions of law. Judgment is entered in favor of the defendant-appellees and against the plaintiff-appellant Panhandle Eastern Pipeline Company as set forth above to be effective this date. Costs of the action are taxed to plaintiff.

Dated this 20th day of May, 1970.

/s/ Phillip L. Woodworth
District Judge

APPENDIX H

CONSTITUTION OF THE UNITED STATES

Article I, Section 8

Clause 3. *The Congress shall have power* * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Amendment XIV

SECTION 1. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

CONSTITUTION OF THE STATE OF KANSAS

Article 11.—Finance and Taxation

§1. *System of taxation; classification; exemption.* The legislature shall provide for a uniform and equal rate of assessment and taxation, except that mineral products, money, mortgages, notes and other evidence of debt may be classified and taxed uniformly as to class as the legislature shall provide. All property used exclusively for state, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes, and all household goods and personal effects not used for the production of income, shall be exempted from taxation.

UNITED STATES STATUTES

Section 2, Natural Gas Act, 52 Stat. 821,15 U.S.C. § 717a

Definitions

When used in this chapter, unless the context otherwise requires—

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regu-

late rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively.

Section 5, Natural Gas Act, 52 Stat. 823, 15 U.S.C. § 717d

Fixing rates and charges; determination of cost of production or transportation

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct

of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

Section 9, Natural Gas Act, 52 Stat. 826, 15 U.S.C. § 717h

Rates of depreciation

(a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses any depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas com-

pany, or the composite depreciation or amortization rate, for the purpose of determining rates or charges.

(b) The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation or amortization rates, shall notify each State commission having jurisdiction with respect to any natural-gas company involved and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations.

KANSAS STATUTES

Kansas Statutes Annotated, (1969 Supp.) 74-2426

74-2426. *Board of tax appeals; final orders; appeals to district court, when; venue; bond; notice of appeal; equity proceeding; referees; evidence; appeals to supreme court; regulations not enforced, when.* Whenever the board of tax appeals shall enter its final order on any appeal, said board shall make written findings of the fact forming the basis of such determination and final order and such findings shall be made a part of such final order. Within ten (10) days after its decision the board shall mail a copy of its order by registered or certified mail to the person, firm, corporation or association who was a party to such appeal. Within thirty (30) days after the mailing of the final order of the board, any party to such appeal may appeal to the district court of the proper county: *Provided,* That no such appeal may be taken to the district court from any order determining, approving, modifying or equalizing the assessment of property for property tax purposes unless such order is unreasonable, arbitrary or capricious: *Provided further,* That an appeal by the director of property valuation may be taken from any such order in which the assessed valuation of the property in-

volved is in excess of fifty thousand dollars ($50,000). Appeals from orders made under the taxation of legacies and successions act shall be to the district court of the county where the estate is being administered, but if the estate is not being administered in Kansas the appeal shall be to the district court of any county where real estate belonging to the estate is located, or if it owns no real estate, then to the district court of Shawnee county if the party appealing is a nonresident, or to the district court of the county where the party appealing resides if the party appealing is a resident of the state of Kansas.

Appeals from orders made under any excise tax act shall be to the district court of the county in which the party appealing resides, or has his principal place of business, or if a nonresident of the state of Kansas, to the district court of the county where he maintains his principal place of business in the state, or if he has no place of business within the state, then to the district court of Shawnee county. Appeals from any final order made by the board as to ad valorem tax liability shall be to the district court of the county in which the property involved is located, or if located in more than one county, then to the district court of any county in which any portion of the property is located. At the time of filing the appeal, the party appealing under any excise tax act, shall give a bond for costs in the sum of twenty-five dollars ($25) conditioned that he shall prosecute the appeal without delay and pay all costs assessed against him, and, in the event that the appeal is by a party other than the director of property valuation and is from an order determining the amount of tax assessable and the tax has not been paid, an additional bond in an amount equal to twice the amount of the tax assessed. The appeal shall be taken by filing, with the clerk of the district court of the proper county, a written notice stating that the party appeals to the district court

and alleging the pertinent facts upon which such appeal is grounded. Upon filing of the notice of appeal, the director shall be deemed to be a party to such appeal, and the clerk of the district court shall docket the cause as a civil action, and shall forthwith and without praecipe issue summons and cause the same to be served upon the director, in accordance with the manner now provided by law in civil cases. Jurisdiction to hear and determine such appeals is hereby conferred upon the district courts of this state. Such an appeal shall be heard as an equity proceeding, and shall proceed as an original action. Trial may be had or any order made in term or vacation.

The district courts are empowered to appoint referees, either standing or special, to hear the evidence and recommend findings of fact and conclusions of law. The transcript of the proceedings had at the hearing before the board of tax appeals may be admissible in evidence. Appeals may be taken from the district to the supreme court by the party appealing or by the director as in civil cases, except that the director shall not be required to give bond on appeal. The final decision made in such appeal shall be entered as a judgment as in other civil cases against the party appealing or against the director, as the case may be. In hearing and considering any such appeal, the court shall not enforce or give effect to any rule or regulation which it shall find to be unreasonable, arbitrary or capricious. [K.S.A. 74-2426; L. 1969, ch. 368, § 1; April 25.]

Kansas Statutes Annotated, (1964) 79-501

"*Valuation and 30% assessment of real and personal property.* Each parcel of nonexempt real property shall be valued at its justifiable value in money, the value thereof to be determined by the assessor from actual view and inspection of the property; but the price at which such real property would sell at auction or forced sale shall not be taken as the criterion of such justifiable value. Tangible personal property shall be valued at the usual selling price in money at the place where the same may be held; but if there be no selling price known to the person required to fix the value thereon, it shall be valued at such price as is believed could be obtained therefor in money at such time and place. All such real and tangible personal property shall be assessed at thirty percent (30%) of its justifiable value."

Kansas Statutes Annotated, (1968 Supp.) 79-503

"*Justifiable value, how determined, factors.* Justifiable value shall mean the value of real estate which is arrived at after applying factors hereinafter set forth.

To arrive at the justifiable value of real property the assessor or appraiser shall actually view and inspect the property. The price at which real property would sell at auction, forced sale or any transaction in which personal elements were a factor regarding the sale price shall not be taken into consideration in determining the justifiable value. In determining the justifiable value of real property, the assessor or appraiser shall consider that value in money arrived at when the following factors or combinations thereof are considered:

(a) The proper classification of lands and improvements;

(b) the size thereof;

(c) the effect of location on value;

(d) depreciation, including physical deterioration or functional, economic or social obsolescence;

(e) cost of reproduction or improvements;

(f) productivity;

(g) earning capacity as indicated by lease price or by capitalization of net income;

(h) rental or reasonable rental values;

(i) sale value on open market with due allowance to abnormal and inflationary factors influencing such values;

(j) comparison with values of other property of known or recognized value; and

(k) valuations of land and improvements on the basis of the foregoing elements and such other elements as may be just and proper.

It shall be unlawful to determine justifiable value of real property in any manner other than authorized and provided for in this section. Any person authorized to assess or equalize property shall consider class, location, productivity, rental values and capitalization." [K.S.A. 79-503; L. 1965, ch. 515, § 1; June 30.]

Kansas Statutes Annotated, 79-1409

79-1409. Board of equalization; powers; appeals; meetings; changes in valuation, effect; certifications of equalized values; apportionment of state taxes. The state board of tax appeals shall constitute a state board of equalization, and shall equalize the valuation and assessment of property throughout the state; and shall have

power to equalize the assessment of all property in this state between persons, firms or corporations of the same assessment district, between cities and townships of the same county, and between the different counties of the state, and the property assessed by the director of property valuation in the first instance. And any person feeling aggrieved by the action of the county board of equalization may, within forty-five (45) days after the decision of said board, appeal to the state board of equalization for a determination of such grievance.

It shall be the duty of the state board of equalization to meet in its office, or such other place within any county of the state as the board shall deem advisable, to perform the work of equalization as hereinbefore provided. Such board may meet at any time on and after January 15 of each year as it may deem necessary and shall meet from the 11th day of July, or the next following business day if such date shall fall on a day other than a regular business day, until the 25th day of August as the business of the board shall require. Whenever the valuation of any taxing district, whether it be a county, township, city, school district, or otherwise, is changed by the state board of equalization, the officers of such taxing district who have authority to levy taxes are required to use the valuation so fixed by the state board as a basis for making their levies for all purposes. In case a change is made in such valuation, said board of tax appeals shall certify the equalized values to the director of property valuation who shall forthwith certify the same to the county clerks of the several counties of the state or to the counties affected by such equalization; and the said county clerks shall carry the real estate and tangible personal property on the tax rolls of their respective counties at the valuations so certified, and shall use such valuations as the basis of all tax levies: *Provided, however*, That any certification

received by a county clerk after August 25 may be handled as an abatement, refund, or added tax as the certification warrants.

The director of property valuation shall apportion the amount of tax for state purposes as required by law to be raised in the state among the several counties therein, in proportion to the valuation of the taxable property therein for the year as equalized by the state board of equalization. [L. 1933, ch. 117, § 1 (Special Session); L. 1959, ch. 374, § 1; L. 1963, ch. 466, § 1; L. 1969, ch. 368, § 2; April 25.]

Kansas Statutes Annotated, 79-1426

79-1426. Penalties for failure of officer to list, return or properly value property. Any county assessor, deputy assessor, member of the state board of tax appeals, director of property valuation, or member of any county board of equalization, and every other person whose duty it is to list, value, assess or equalize real estate or tangible personal property for taxation, who shall knowingly or willfully fail to list or return for assessment or valuation any real estate or personal property, or who shall knowingly or willfully list or return for assessment or valuation any real estate or personal property at other than its justifiable value in money, or any assessing officer who shall willfully or knowingly fail to assess or to equalize the assessments of any real estate or tangible personal property, which is subject to general property taxes, at thirty percent (30%) of justifiable value in money, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall be fined in any sum not exceeding five hundred dollars ($500) or imprisonment in the county jail for a period not exceeding ninety (90) days, and in addition thereto shall forfeit his office if an officer mentioned herein. A variance of 10%, of 30% shall not be considered a violation of this

section. [L. 1907, ch. 408, § 89, L. 1909, ch. 251, § 8; R.S. 1923, 79-1426; L. 1963, ch. 480, § 6; June 30.]

Kansas Statutes Annotated, 79-1435

79-1435. Assessment ratio study or real property sales; definitions. As used in this act: (1) The words "real estate" shall include lands and the improvements and structures thereon which are taxed as real property; (2) the word "director" means the director of property valuation; (3) the words "sale" or "sold" shall include all sales which shall be found by the director to be indicative of the value of the real estate sold. (4) "Urban property" shall include all real estate located within the boundaries of an incorporated city; and shall also include property located outside a city which is platted or subdivided into lots or which are tracts used for nonfarm purposes. (5) "Rural property" shall include all real estate which is not defined as "urban property." [L. 1949, ch. 224, § 1; L. 1965, ch. 516, § 1; L. 1967, ch. 489, § 1; July 1.]

Kansas Statutes Annotated, 79-1436

79-1436. Same; reports by registers of deeds. On or before the tenth day of each month every register of deeds with the advice and assistance of the county assessor shall prepare, compile and forward to the director a report of every tract or piece of real estate which has been or shall be either sold, transferred, or contracted to be sold or transferred in his county the conveyance or agreement evidencing the same having been recorded in the office of the register of deeds during the calendar month immediately preceding. Such reports shall be prepared and furnished as required by the director and shall show:

(1) The date of the sale, transfer or agreement as evidenced by the date of the execution of the instrument;

(2) The purchase price of the particular tract or piece of real estate as shown by the instrument;

(3) The value of such tract or piece of real estate as reflected by the certificate of value;

(4) The amount of any mortgage on said tract or piece of real estate assumed by the purchaser, including any purchase money mortgage, executed by the purchaser;

(5) The assessed valuation of said tract or piece of real estate as of the date the instrument was executed as shown by the county assessment roll; and

(6) The classification and subclassification of the property sold, transferred or contracted for sale.

(7) Such other information from the register of deeds or the county assessor as the director deems necessary to carry out the purposes of this act. The above named county officers and the director and his agents shall have the right of access to the assessment rolls and other records in the offices of the county clerks, county assessors and registers of deeds for the purpose of securing information required by this act. [L. 1949, ch. 224, § 2; L. 1965, ch. 516, § 2; L. 1967, ch. 489, § 2; July 1.]

Kansas Statutes Annotated, 79-1437

79-1437. Same; sales price and ratios to be computed by director; annual report and publication of ratios. Upon receipt of the reports of real estate sales and other information, the director shall determine, as nearly as possible, the sale price of each tract or piece of real estate and the ratio of the assessed valuation to the sale price; and, after this ratio has been determined for all sales in any one year, said director shall determine the average ratio of all sales in each such county for such year. The director shall likewise determine for each year the average ratio of all

sales in all counties of the state. In determining the ratio of sales as required in this section, the director of property valuation shall, in all sales of property in which there is to be a change in the classification or subclassification of the property place such sale in the proper classification, or subclassification, and such sale resulting in a change of classification shall not be used in determining the ratio of the prior classification. Such ratios for each year shall be published annually by the director in convenient form for the use and information of the legislature, the Kansas legislative council, taxpayers and other interested parties and public officers. The annual report of the director of property valuation published as required by this section, shall include reports of county and state ratios based on urban and rural classification, and shall include studies made by the department based on the subclassifications provided for by this act. [L. 1949, ch. 224, § 3; L. 1965, ch. 516, § 3; L. 1967, ch. 489, § 4; July 1.]

Kansas Statutes Annotated, 79-1441a

79-1441a. Determination of ratios; appeal by board of county commissioners to board of tax appeals; findings; corrections, when; approval of publication. Each year when the ratios are determined, the director shall notify the board of county commissioners of each county of the ratios determined for such county. If the board of county commissioners disagrees with the ratios determined for such county, the board may, within ten (10) days after receipt of such notice, appeal such determination to the state board of tax appeals. Any such appeal shall be commenced by written notice thereof served by registered mail on the board of tax appeals and the director of property valuation. The board of tax appeals shall hear the board of county commissioners and the director of property valuation and shall make a finding as to whether, in deter-

mining the ratios for the county, sales from the prior year should have been used to supplement sales from the current year as provided in K.S.A. 1965 Supp. 79-1443, whether appraisals should have been made as provided in K.S.A. 1965 Supp. 79-1443, whether the law has been complied with, and whether such other procedures as may be provided by law or regulations were followed properly. If the board of tax appeals finds that the prescribed procedures were not followed it shall advise the director of property valuation who shall correct any deficiency and report back to the board prior to publication of the ratio study. No ratio which has been appealed shall be published until such publication is approved by the board of tax appeals. [L. 1967, ch. 489, § 7; July 1.]

Kansas Statutes Annotated, 79-1443

79-1443. Same; use of prior year sales, when; appraisals. Sales from the prior year may be used to supplement sales of the current year by the director if in his opinion the sales in the current year are insufficient to determine the assessment ratio of any county. For the same purpose the director may obtain appraisals. [L. 1965, ch. 516, § 5; June 30.]

SUPREME COURT, U. S.
MAY

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1152

PANHANDLE EASTERN PIPELINE COMPANY,
Petitioner,

vs.

RONALD F. DWYER, Director of Property Valuation of the State of Kansas, et al.,
Respondents.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

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In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1152

PANHANDLE EASTERN PIPELINE COMPANY,
Petitioner,

vs.

RONALD F. DWYER, Director of Property Valuation of the State of Kansas, et al.,
Respondents.

MOTION TO DENY PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

Come now the Respondents and respectfully move the Court to deny the petition for writ of certiorari to the Supreme Court of Kansas in the above matter because it fails to show that the validity of any treaty or statute is drawn in question, and because it fails to show that any title, right, privilege or immunity of petitioner, specially set up or claimed under the Constitution of the United States or any statute

thereunder, has been infringed or denied by respondents or the Kansas Courts.

Respectfully submitted,

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GENERAL NATURE OF THE CASE

When this case was decided by the Supreme Court of Kansas on May 15, 1971, it was a forerunner of a series of litigated challenges by interstate utilities of the Kansas 1969 state assessment for ad valorem purposes, both by direct appeals, and by tax protest actions.

The original decision, *Panhandle Eastern Pipeline Co. v. Dwyer,* 207 Kan. 417, 485 . 2d 149, was decided, in a Johnson County direct appeal action, in favor of the state assessment by a Kansas Supreme Court divided four to three. *(A 1) The same day, another case, *Panhandle Eastern Pipeline Co. v. Herren,* 207 Kan. 400, 485 P. 2d 156, a Reno County tax protest case, was unanimously decided against the state and remanded on procedural grounds. The petitioner, Panhandle, filed motions for rehearing in both cases, and the motions both were sustained.

Meanwhile, Northern Natural Gas Co., had three appeals being readied for oral argument: *Northern Natural Gas Co. v. Dwyer,* 208 Kan. 337, a direct appeal from Pawnee County, and two tax protest cases, one from Rice County, *Northern Natural Gas Co. v. Williams,* 208 Kan. 407, from Rice County,

* References are made to pages in petitioner's appendix.

which had been tried on its merits, and one from Clay County, *Northern Natural Gas Co. v. Bender,* 208 Kan. 135, which had been decided on procedural grounds favorably to the state. Northern was granted a motion to accelerate the hearing to the fall docket.

The Northern Natural Gas Co. cases are now docketed before this Court, numbered 71-1104, 71-1105 and are being consolidated for motions and briefs.

The Kansas Supreme Court set all five of these cases for oral argument on the same day, September 21, 1971. Practically the entire day was devoted to these cases.

The Kansas Court later disposed of other of petitioner Panhandle's protest tax cases, one a consolidation of six county cases, *Panhandle Eastern Pipeline Co. v. Tieperman,* 208 Kan. 252, and *Panhandle Eastern Pipeline Co. v. Jones,* 208 Kan. 280, four county cases.

The Kansas Court also disposed of the rehearing of the Panhandle tax protest case in Reno County, 208 Kan. 304, by affirming its original decision, but modifying it. All of these cases were appeals with reference to procedure under K.S.A. 79-2005, the tax protest statute.

There would seem to be great importance to the point that, upon rehearing, one of the judges who dissented (A 17) in the Panhandle direct appeal decision, concurred with the majority on rehearing (A 20), leaving only two dissenting. But more, this same judge wrote the opinion for the majority in the Northern direct appeal from Pawnee County, to which there was but one dissent. This Northern decision (A 30) should be considered in connection with this Panhandle appeal, because substantially the state used the same appraisal practices and procedures on both valuations and assessments and applied the same statutes in the same tax year to utilities of a similar class. Furthermore, this same judge wrote the

opinion in the Northern Natural Gas Company tax protest case now before this court in Case #71-1105. (See Appendix of that case at page A 52).

There is no dispute as to the basic facts concerning the nature, extent and inventory of the physical property of petitioner, both system-wide and in Kansas. (A 3) Respondents have accepted the figures from Petitioner's rendition, both on the balance sheet and in the income statement. (A 3) It is agreed that the Kansas allocation percentage out of petitioner's total system value in 1969 is 29.47%.

The controversy arises because of the appraisal conclusions drawn from those facts, and the interpretation of Kansas statutes pertaining to ad valorem taxation when applied to those facts. Also, there is a question whether the 1968 Kansas Sales Ratio Study, standing alone, is a conclusive indicator of the 1969 level of assessment of real estate in Kansas in relation to the market value of Kansas real estate in 1969.

THE ISSUES

1. **Have respondents, in the state assessment of petitioner's Kansas property for 1969 ad valorem tax, used an appraisal that followed the Kansas statutory listed factors and criteria? Petitioner charges that respondents used only the undepreciated original cost, and contends that, instead, the sole criteria to determine the value of petitioner's property should be original cost, less the straight-line depreciation, or rate base, and capitalization of the net income allowed by FPC on rate base.**

On this issue, the Kansas Board of Tax Appeals (A 102), the Kansas District Court (A 115) and the Kansas Supreme Court (A 11) found, after examining respondents' appraisal, that all applicable statutory factors had been followed.

2. Is the 5% rate, selected by respondents to capitalize petitioner's FPC "net operating income," unreasonably low?

Respondents contend that 5% is a reasonable rate after consideration of all of the financial facts as revealed in petitioner's rendition. The Kansas Board of Tax Appeals (A 102), the Kansas District Court (A 112) and the Kansas Supreme Court (A 11) found that the 5% rate was reasonable.

3. Does the 1968 Kansas Sales Ratio Study, standing alone, conclusively prove the level of the 1969 Kansas assessment of real estate in relation to the *justifiable or fair market value of such real estate?

Again, at all three levels of the Kansas judiciary process, it was found against the contention of petitioner. (A 12, 102, 119)

THE COST APPROACH

Since petitioner is undertaking to use a single cost approach — original cost less FPC straight-line depreciation or rate base, petitioner undertakes to construe respondents' appraisal to have used also a single cost approach — undepreciated original cost.

Respondents' appraisal has been in the record, as State's Exhibit B, at all three levels before the Board, District Court, and Supreme Court of Kansas. It shows that three cost approaches were used to indicate values as of assessment date, January 1, 1969: a) Original Cost — $186,928,324; b) Original Cost less depreciation — $123,523,501; and c) Reproduction Cost less depreciation — $196,888,770. In the Reproduction

* "True Value," "justifiable value," "actual value in money" all mean fair and reasonable value for taxation purposes. *Board of County Commissioners v. Brookover*, 198 Kan. 70, 77, 422 P. 2d 906 (1967).

Approach, respondents used the Handy Whitman Index for trending purposes, bringing the 1968 trended cost to assessment date, and then deducted 3½% for depreciation. After that, new plant in 1968 and materials and supplies were added. (*R 373) On the next page, respondents preformed a capitalization of income approach to value, one on the 1968 income and the other on a three year average income, and respondents used the latter, noting that since 1964 revealed an increase of over 35% in net operating income and that three years average income should be used to avoid radical adjustments of income due to plant growth. Respondents then applied a 5% capitalization rate, which produced an indicator of value of $176,313,470. (R 374)

Respondents' appraisal contained a correlation of value indicators and further gave a percentage weight to those approaches used, as follows:

Income approach	20%
Original cost approach	40%
Reproduction cost less depreciation	40%

Respondents then reached an appraisal conclusion of market value as $187,676,054. (R 372)

Petitioner has failed to tell the whole story. The facts are that the first 1969 notice went out to petitioner as a valuation of $187,676,054 with an assessed value of $56,302,800. Petitioner asked for a hearing before the Director and complained that the valuation was excessive. Following that hearing, the respondent Director did grant petitioner a slight reduction on May 28, 1969, and did reduce petitioner's valuation to $186,928,324 and an assessed value of $56,078,497. He did this by drawing a line through the first set of figures, and

* Record references are to the Record on Appeal before the Kansas Supreme Court, which is part of the certified record before this court.

then writing in the second set. (R 202, Taxpayer's Exhibit 1, and R 377, State's Exhibit C)

Not being satisfied with such reduction, petitioner appealed. Upon trial before the Board of Tax Appeals, petitioner called the respondent Director to the stand and questioned him about his having made his final figures the same as original cost. He answered: "It may have ended up that that, it wasn't the purpose. In other words, I didn't just take a certain percent of original cost." (R 59) The Director had given original cost 40% weight in the appraisal, and it was in the middle of the value indicators. (R 372)

The respondent Director later testified, when asked if it were possible to come out at original cost by using the trended and depreciation methods. He answered: "This method will generally tend to bring a value by appreciation and depreciation in a close proximity to what the original investment figure for the company is." (R 64). He then testified that he had checked this out with appraisals of other companies as well as Panhandle Eastern.

The testimony of the staff appraiser confirmed the director's testimony. He explained his appraisal and the change after the hearing. (R 162). He objected to FPC rate base being used to set value for taxation. He said: "If it were, there would be no need for appraisal of that property." (R 165) Later he identified State's Exhibit E (R 379) on which he had compared the assessments of petitioner, Northern Natural and several other similar utilities. He used both Handy Whitman Index and the Engineering News Record. He testified that the trended approach of appreciation and depreciation comes out "very close" to original cost. (R 178)

Petitioner's brief contends that original cost is not one of the factors specified by K.S.A. 79-503. Petitioner just refuses to look at "(e) cost of reproduction or improvements." Cost

of improvements is original cost. Petitioner is the same as Northern Natural Gas, of whom the Kansas Supreme Court said: "Apparently Northern would like to ignore this factor." (A 199 of Appendix in case #71-1105) Petitioner valuation witness here declined to compute any trended reproduction cost new less depreciation, even though it was a statutory factor, an accepted appraisal practice and the MAI manual called for it. (R 132-135)

It would appear that the main difference between the parties is that respondents contend that both appreciation and depreciation must be considered to arrive at justifiable and fair market value on January 1, assessment date.

But petitioner has undertaken to be valued only on rate base original cost less the FPC straight-line depreciation. There is the rub.

The required FPC "depreciation expense" of 3½% annually out of gross revenues allows petitioner to recapture in full, in slightly over 28½ years, its entire plant investment. (A 3) Petitioner admits in the record it has plant in service in Kansas that is 38 years old on assessment date. (R 33)

It is reasonable that respondents refuse to join petitioner and the FPC in pretending that this 38 year old property, still in service, has no market value for tax purposes. No well informed and prudent purchaser would discard this fact. In Kansas it is traditional to value property at some value for ad valorem purposes, regardless of age, if it is still in use. A house or store may be 100 years old, but, if it is still in use, it is appraised and taxed. There is no "straight-line" depreciation whereby property can lose its entire value while still in use. The principle of equality and uniformity of tax burden compels respondents to treat petitioner and other utilities the same as other Kansas taxpayers.

THE INCOME APPROACH

Respondents also ran an income approach by capitalizing at 5%. Petitioner claims such rate is unreasonably low and produces "a grossly excessive valuation." Petitioner's witness used a capitalization rate of 7%, which he derived from the money and bond markets, including common stock equity discount rates. (R 107). Since both parties were using the same income figures, the rate was the main issue.

Respondents explained the adoption of a 5% rate after scrutinizing the income stream that was being capitalized. Before the Board of Tax Appeals, the District Court and the Kansas Supreme Court, respondents kept pointing to the excessive recapture privileges granted by FPC in that petitioner was allowed in 1968 to take out of gross revenues in disposable cash the sum of $19,776,957. This sum was deducted on its FPC income statement on line 403 before determining "net operating income." (R 205) And this had been true year after year after year. Appellant is by its own records a half billion dollar utility. (R 204) Therefore, each year it is recapturing in cash 3½%. It is a positive guaranteed FPC recapture PRIOR to the demise of the service plant life, and this would be a highly sensitive point to a purchaser in the open market, and certainly it is a factor that should be considered by an appraiser striving to arrive at fair market value by following accepted appraisal practices.

The Court has on several occasions frowned upon excessive charges to operating expenses for depreciation reserves. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 606, 64 S.Ct. 281, 88 L.Ed. 333 (1944); *Lindheimer v. Illinois Tel. Co.*, 292 U.S. 151, 168, 169, 54 S.Ct. 658, 78 L.Ed. 1182 (1933); *Board of Public Utility Comm. v. N.Y. Tel. Co.*, 271 U.S. 23, 30, 46 S.Ct. 363, 70 L.Ed. 805 (1925); *Louisiana Ry.*

Comm. v. Cumberland Tel. & Tel. Co., 212 U.S. 414, 424, 425, 29 S.Ct. 357, 53 L.Ed. 577 (1908).

Before the Board of Tax Appeals, the District Court and the Supreme Court of Kansas, respondents pointed to the fact that before arriving at "net operating income" petitioner in 1968 deducted out of gross revenues the sum of $3,691,400.00, on line 409, to pay for all income taxes, state and federal. (R 205)

Respondents contend that to follow proper appraisal practice it is necessary to know and to examine the nature and character of the income stream about to be capitalized. Here, a purchaser for value in money would recognize he would get a return OF investment, as well as return ON investment, and all would be state and federal tax FREE, and so he would accept a lower rate of return ON investment. That really would be in the nature of a tax free interest rate, as might be expected from a municipal bond. Five per cent would have been fair enough on January 1, 1969.

Perhaps, one point should be explained. One dissenting judge commented that it was an "arbitrary" choice for the respondent Director to use a 5% capitalization rate in the Panhandle case and a 5.5% rate in the Northern case. (A 24) It is just as "arbitrary" as the exercise of judgment by the Federal Power Commission in setting a rate of return of 6⅝% for Panhandle (A 3), while at the same time and in the same year setting a rate of 6.8% for Northern. (A 43)

It is just as "arbitrary" as the valuation witnesses of these very utilities selecting a capitalization rate of 7% in Panhandle (A 10) and an 8½% rate in Northern. (A 52) The similarity of the difference in the rates of the two companies by all exercising appraisal judgment should be noted.

There is another point that merits comment with respect to the selection of a 5% capitalization rate by respondents.

It is the sale of Great Lakes Pipeline to Williams Brothers Co. Respondents used this sale, not market data to indicate the system value of Panhandle, but to prove a) that a knowledgeable buyer would pay more than rate base for a regulated pipeline; b) that such buyer would accept less than 5% current rate of return ON his investment; and c) that the rate of return on investment in a regulated company can increase in years subsequent to the purchase.

Respondents introduced its worksheet on this sale into evidence. (Exhibit D, R 378) Testimony concerning it is in the record. (R 165-172) Petitioner's own witness admitted it is proper appraisal procedure to research the market place to see the rate of return on investment buyers expect. (R 138-139)

It is respectfully submitted that there is in the record exhibits and testimony sufficient to justify the reasonableness by respondents in making their income approach to value of petitioner's property.

THE SALES RATIO STUDY

Whether the 1968 Sales Ratio Study (R 206-239, Exhibit 4) can be used for tax assessment appraisal and apportionment purposes is critical in this appeal. Petitioner not only wants its appraisal to be adopted as the 100% justifiable value, but that in addition the Court order an allocation of such reduced value, not at 30% (R 4), but at the median sales ratio study percentages for each county in Kansas in which petitioner has installations. (R 11)

Petitioner's theory is that sales and justifiable value are the same and equal. (R 62) Here lies a basic issue upon which this appeal is predicated.

Respondent Director testified that it had been the policy of his office not to use the Sales Ratio Study for tax appraisal

purposes, and that this policy had recently been enacted into law. (R 63). The Director testified that the Ratio Study was an annual sampling of sales of real estate which varied among counties from five-tenths of one per cent to four and one-half per cent of the total parcels within the county. (R 62-63)

It is the Director's position that the Kansas Legislature did not intend the Ratio Study to be used as an appraisal of justifiable or fair market value for tax appraisal purposes; that the Ratio Study has a special statutory function, and that in the 1969 sessions the legislature refined the classifications and subclassifications of the Ratio Study so that it can better serve its specific statutory function. (K.S.A. 79-503, 79-1436a, 79-1436b copies of which laws are attached to this response, see Appendix hereto, pages 29-32) The 1969 amendments affect the 1969 Sales Ratio Study and the use of that study.

Petitioner offered no evidence in support of the theory that the Ratio Study should be equated with justifiable value except the testimony of Dr. Francis Woodard that he had helped prepare it. (R 70-71) Dr. Woodard does not use the words "justifiable or fair market value" in relation to the Ratio Study. He repeatedly refers to the Ratio Study as the "Sales" ratio study. (R 70-82) He does declare the accuracy of the sales ratio study. (R 73)

But the Director has never denied the accuracy of the sales ratio study. He would not do so, having directed the compilation and publication of the study. Where the controversy arises is when petitioner wants to equate the median or middle ratio card to ALL the land in a county, including petitioner as a utility.

COEFFICIENT OF DEVIATION

K.S.A. 79-1436b, says that: "In the taxable years commencing after December 31, 1971, whenever the Director of

Property Valuation shall determine that the coefficient of deviation of any one classification or subclassification of property in a county, as shown by the ratio studies, is greater than 20, he is authorized and DIRECTED to order all property within such classification or subclassification within such county to be reappraised."

Coefficient of Deviation was actually not a "new" term. The 1968 Ratio Study, Exhibit 4, defines the term (R 211) and then (R 224-232) spells out the coefficient of deviation for every Kansas county. This is petitioner's exhibit. This just follows former surveys. The coefficient of deviation is the goal of these surveys. Why? Because this is what shows the need of reappraisal. It shows that the median is not stable. It shows need to check appraisal of a classification or subclassification. It does NOT show that everybody, including utilities, should be equalized with the median.

Every Ratio Study reflects the number of ratio study cards used. (R 216-219, Exhibit 4) This is done by county. It is at once apparent that these cards in the various counties range from less than 5% to more than 120% when the sales price is compared to the assessed valuation.

The established "middle card" is the "median." The ratio of that card is then attributed to that county.

Now, "coefficient of deviation" is a further computation. It is the percent deviation of each sale to the median sale; totaled, and then divided by the number of sales; expressed in percent as an average deviation; then divided by the percent of the median sale. The coefficient of deviation denotes only the degree of equality or non-equality for that particular class of property, comparing the assessed value only to raw sales price. If the coefficient of deviation is more than 20, then the legislature has declared a breaking point and directed a reappraisal in K.S.A. 79-1436b, after December 31, 1971.

This is the only statute that says how the ratio study shall be used in the tax appraisal process. *It is a reappraisal tool.*

The Supreme Court of Kansas recognized, even before it was specifically set out in the statutes, that the ratio study served as a sound basis for making an order of reappraisal. *Board of County Comm. v. Brookover,* 198 Kan. 70, Syl. #10, 422 P. 2d 906 (1967).

The failure of the Kansas Legislature to change the ratio study laws after it received the Brookover judicial construction amounts to legislative approval of the court's interpretation. *McIver v. State Highway Comm.,* 198 Kan. 678, 426 P. 2d 118 (1967). The subsequent enactment in 1969 of K.S.A. 79-1436b stating that the specific use of the ratio study shall be for reappraisal purposes confirms legislative approval of Brookover.

When the legislature adds something to an existing statute there is a presumption that there was an intention to supply some want, to fill some deficiency, to add something to make existing legislation more complete, to clarify legislative intent. *Consumers Co-op Ass'n. v. State Commission of Revenue and Taxation,* 174 Kan. 461, 256 P. 2d 850 (1953).

Where the Legislature states its interpretation of language then or previously used in a statute, that interpretation is entitled to great weight. *Richardson v. Kansas Soldiers' Compensation Board,* 150 Kan. 343, 92 P. 2d 114 (1939).

Where a former statute is amended or a doubtful meaning of a former statute rendered certain by subsequent legislation, such amendment or recent legislation is strong evidence of what the legislature intended by the first statute. *Kucera v. State,* 160 Kan. 624, 164 P. 2d 115 (1945).

Early in the 1969 session of the Kansas Legislature K.S.A. 79-503 was amended. That amendment is set forth in an appen-

dix attached to this response. (P. 29) This law was enacted prior to the 1969 valuation and assessment of petitioner's property by respondent, and became effective before the first hearing thereon before the Kansas Board of Tax Appeals.

The Kansas Legislature gave positive evidence of legislative intent with these words concerning the Sales Ratio Study:

> "Sales in and of themselves shall not be the sole criteria of fair market value but shall be used in connection with cost, income and such other factors as may be appropriate including but not by way of exclusion:"

The statute then recites the factors listed in the 1968 law, including (e), but added to (j) are these words, "The ratio study shall not be used as an appraisal for appraisal purposes."

There is another important addition by the 1969 amendment to K.S.A. 79-503. It is the classification of real property into two major classes of urban and rural, and then dividing rural into six subclasses listed therein. This refinement of the rural property was needed to clarify much confusion in the Rural Sales Ratio. This fact is mentioned by the Kansas Supreme Court in the Rice County decision. (A 62-64)

To complete the legislative plan, the 1969 Kansas Legislature also passed K.S.A. 79-1436a and 79-1436b, which are also in the appendix attached to this response. (P. 29) They establish that the ratio study must be used as a reappraisal indicator. But petitioner never was interested in this case in a reappraisal of any particular county. Even when challenged to file a complaint under K.S.A. 79-1413a, a reappraisal statute, even when challenged to bring in local county officials, petitioner declined. (R 40)

There is a peculiar consistency between petitioner wanting to be appraised on a single factor – rate base, and then wanting a further reduction in value to another single factor –

the median sales ratio card. This is consistent use of single factors in achieving justifiable or market value in money contrary to Kansas legislative intent as prescribed in K.S.A. 79-503.

HISTORY OF UTILITY RATE VALUATION AND REGULATION

Valuation for rate purposes of public utilities has had an interesting and involved history of development in this country. *Munn v. Illinois*, 94 U.S. 113, 124, 125, 24 L.Ed. 77 (1876); *Smyth v. Ames*, 169 U.S. 466, 547, 18 S.Ct. 418, 42 L.Ed. 819 (1898); *Knoxville v. Knoxville Water Co.*, 212 U.S. 1, 13, 14, 29 S.Ct. 148, 53 L.Ed. 371 (1909), and *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 29 S.Ct. 192, 53 L.Ed. 382 (1909); *Southwestern Bell Tel. Co. v. Public Service Comm.*, 262 U.S. 276, 43 S.Ct. 544, 67 L.Ed. 981 (1922); *Los Angeles Gas Co. v. R.R. Comm.*, 289 U.S. 287, 53 S.Ct. 637, 77 L.Ed. 1180 (1932); *Driscoll v. Edison L. & P. Co.*, 307 U.S. 104, 59 S.Ct. 715, 83 L.Ed. 1134 (1938); *Natural Gas Pipeline Co. v. F.P.C.*, 315 U.S. 575, 62 S.Ct. 736, 86 L.Ed. 1037 (1941); *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 63 S.Ct. 281, 88 L.Ed. 333 (1944); *Permian Basin Area Rate Cases*, 390 U.S. 747, 757, 20 L.Ed. 2d 312, 88 S.Ct. 1344 (1967).

In this evolution from "fair value" as undepreciated original cost, through "reproduction new, less depreciation" with a recapture feature, the "fair return" concept, and finally "just and reasonable end result," valuation for rate purposes has never included the usual and accepted appraisal practices of reaching "fair market value," needed for ad valorem taxation.

As Justice Jackson said in a concurring opinion in the Hope case:

> "The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the results than in a game of poker." (p. 649)

The above cases were cited and followed by the Kansas Supreme Court in *Southwestern Bell Tel. Co. v. State Corporation Commission*, 192 Kan. 39, 69, 386 P. 2d 515 (1963). In that case, the Kansas Court said: "Reasonable value for rate-making purposes is not the literal present fair value for each and every purpose, but is the reasonable value as that term is understood for the purpose of determining a fair and reasonable return. In this respect, the term "reasonable value" as used in G.S. 1949, 66-128, has a connotation peculiar to rate proceedings." (p. 65)

Having failed in getting the Kansas Supreme Court or the United States Supreme Court to determine rate base on the fair market value appraisal principles, the utilities in this volume of litigation have tried the only other available tact: to make rate base synonymous with market value. If rate base equals market value, then the reverse (and an equation is a two way street) is that market value equals rate base. This is the explanation of this whole legal war of some 600 various law suits in Kansas Courts.

VALUATION OF UTILITIES FOR AD VALOREM TAX

The growth and development of the imposition of state property tax upon interstate utilities had had even a longer history than the rate cases. In doing so, there has not been a commingling in these cases of the true cash or market value needed for property tax and the value used for rate base, as is attempted in this appeal.

The United States Supreme Court approval of state valuation and tax assessment of interstate utilities possibly commenced with *Philadelphia, Wilmington and Baltimore Ry. Co. v. Maryland,* 10 Howard 376, 394, 13 L.Ed. 461 (1850). The opinion written by Chief Justice Taney held that there was no exemption of such corporations or reason why their property, real and personal, should not bear its share of the state's public burden.

The first Kansas case was *Missouri Ry. Co. v. Morris,* 7 Kan. 210 (1871). Justice Valentine wrote the opinion which upheld an 1869 Kansas law establishing a Board of County Clerks to value and assess railroad property in Kansas on a whole system basis, and then apportion it to the counties on the basis of miles of track in each county. This apportionment is still the law today. K.S.A. 79-606. Justice Brewer was a member of the Kansas Supreme Court when this decision was handed down. Here is some interesting language in that decision:

> "The constitution does not require that the MANNER OR MODE OF ASSESSING AND TAXING property, or the manner and mode of COLLECTING THE TAXES, shall be equal and uniform; but it simply requires that all property shall be assessed and taxed at AN EQUAL AND UNIFORM RATE." (pp. 221-222, Emphasis by the Court)
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> "As we have already stated, a railroad is an entire thing, and cannot well be valued or assessed except as a whole. Hence the provision of the act that provides for taking the entire value of the road and dividing it up by a certain rule for each county, township, etc., through which the road runs, is, at least, a reasonable rule, and, except in rare cases, is probably as good a rule for deter-

mining the true value of each particular portion of the road as any other rule that could be adopted." (pp. 221-223)

This *Missouri River Ry. Kansas* case (pp. 223-224) was cited to the United States Supreme Court in the *State Railroad Tax Cases*, 92 U.S. 575, 23 L.Ed. 663 (1875), by the Attorney General of Illinois in support of an 1872 law. The issue was whether an interstate railroad could be valued and assessed as a unit and then allocated to taxing districts on the basis of miles of track. That decision held:

"It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road, and apportion the value within the county by its relative length to the whole." (p. 608)

* * *

"But suppose it were otherwise; perfect equality and perfect uniformity of taxation as regards individuals or corporations, or the different classes of property subject to taxation, is a dream unrealized. It may be admitted that the system which most nearly attains this is the best. But the most complete system which can be devised, must, when we consider the immense variety of subjects which it necessarily embraces, be imperfect. And when we come to its application to the property of all citizens, and of those who are not citizens, in all the localities of a large State like Illinois, the application being made by men whose judgments and opinions must vary as they are affected by all the circumstances brought to bear upon each individual, the result must inevitably partake largely of the imperfection of human nature, and of the evidence on which human judgment is founded." (Citing cases) (p. 612)

The unit system of valuating interstate utilities was firmly established, where a state commission was trying to arrive at "actual cash value," by the decision of *Cleveland & C. v. Backus*, 154 U.S. 439, 14 S.Ct. 1122, 38 L.Ed. 1041 (1895). Here are some quotations from that opinion written by Justice Brewer:

> "It is the aggregate of those values plus that arising from a connected operation of the whole, and each part of the road contributes not merely the value arising from its independent operation, but its mileage proportion of that flowing from a continuous and connected operation of the whole." (p. 444)
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> • • •
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> "The rule of property taxation is that the value of the property is the basis of taxation. It does not mean a tax upon the earnings which the property makes, nor for the privilege of using the property, but rests solely upon the value. But the value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines the value, and if property is taxed at its actual cash value it is taxed upon something which is created by the uses to which it is put." (p. 445)

Justice Brewer established even more firmly the unit system of valuing utilities and factors of ad valorem tax valuation to be considered in *Adams Express Co. v. Ohio*, 166 U.S. 185, 17 S.Ct. 604, 41 L.Ed. 965 (1896):

> "Now, it is a cardinal rule which should never be forgotten that whatever property is worth for the purposes of income and sale it is also worth for purposes of taxation." (p. 220)
>
> • • •

"Suppose an express company is incorporated to transact business within the limits of a State, and does business only within such limits, and for the purpose of transacting that business purchases and holds a few thousand of dollars' worth of horses and wagons, and yet it so meets the wants of the people dwelling in that State, so uses the tangible property which it possesses, so transacts business therein that its stock becomes in the markets of the State of the actual cash value of hundreds of thousands of dollars. To the owners thereof, for the purposes of income and sale, the corporate property is worth hundreds of thousands of dollars. Does substance of right require that it shall pay taxes only upon the thousands of dollars of tangible property which it possesses? Accumulated wealth will laugh at the crudity of taxing laws which reach only the one and ignore the other, while they who own tangible property, not organized into a single producing plant, will feel the injustice of a system which so misplaces the burden of taxation. . . . But if the State comprehends all property in its scheme of taxation, then the good will of an organized and established industry must be recognized as a thing of value. The capital stock of a corporation and the shares in a joint stock company represent not only the tangible property, but also the intangible, including therein all corporate franchises and all contracts, privileges and good will of the concern." (p. 221)

In a later decision, the U.S. Supreme Court reaffirmed that all property of a utility should be considered for tax value which augments value by reason of a connected operation of the whole and enhances its value. The state may use and employ any appropriate means of reaching its actual or full value as part of a going concern. *Pullman Co. v. Richardson*, 261 U.S. 330, 43 S.Ct. 366, 67 L.Ed. 682 (1922). Here are excerpts of that decision:

"The state court holds that the tax is not a tax on gross receipts as such, but is in both name and essence a tax on property within the State, and that it is computed with reference to the gross receipts only as a means of adjusting it to the real value of the property in the relation in which the same is used. . . .

"A state can neither tax the act of engaging in interstate commerce nor lay a tax on gross receipts therefrom. In either case the tax would be a restraint or burden on such commerce and its imposition an invasion of the power of regulation confided to Congress by the commerce clause of the Constitution. (Citing cases)

"The rule is otherwise with property used in interstate commerce. A State within whose limits such property is permanently located or commonly used may tax it. (Citing cases)

"And, if the property be part of a system and have an augmented value by reason of a connected operation of the whole, it may be taxed according to its value as part of the system, although the other parts be outside the State; – in other words, the tax may be made to cover the enhanced value which comes to the property in the State through its organic relations to the system. (Citing cases)

"In taxing property so situated and used a State may select and employ any appropriate means of reaching its actual or full value as part of a going concern; – such as treating the gross receipts from its use in both intrastate and interstate commerce as an index or measure of its value; – and if the means do not involve any discrimination against interstate commerce and the tax amounts to no more than what would be legitimate as an ordinary tax upon the property, valued with reference to its use, the tax is not open to attack as restraining or burdening such commerce." (Citing cases) (pp. 337-339)

In 1939 a case arising from Tennessee presented a contention that the assessment of utilities by a state commission, when all other property in the state was valued for taxation by local assessors, was discriminatory because local assessors were far less than true value. The Tennessee Supreme Court held the evidence insufficient to overcome the presumption that the Board had equalized assessments in accordance with the command of state law. The claim was also made that the commission assessment was so greatly excessive of full value as to violate the 14th Amendment. Here are the same two issues that confront the Court on this appeal.

Here are excerpts from that case:

> "This Court has previously had occasion to advert to the narrow and sometimes cramping provision of these state uniformity clauses, and has left no doubt that their inflexible restrictions upon the taxing powers of the state were not to be insinuated into the meritorious conception of equality which alone the Equal Protection Clause was designed to assure. (Citing cases)
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> "That the states may classify property for taxation; may set up different modes of assessment, valuation and collection; may tax some kinds of property at higher rates than others; and in making all these differentiations may treat railroads and other utilities with that separateness which their distinctive characteristics and functions in society make appropriate – these are among the commonplaces of taxation and of constitutional law. (Citing cases)
>
> "Since, so far as the Federal Constitution is concerned, a state can put railroad property into one pigeonhole and other property into another, the only question relevant for us is whether the state has done so. If the discrimination of which the Railway complains had been formally

written into the statutes of Tennessee, challenge to its constitutionality would be frivolous. If the state supreme court had construed the requirement of uniformity in the Tennessee Constitution so as to permit recognition of these diversities, no appeal could successfully be made to the Fourteenth Amendment. . . .

"The Equal Protection Clause did not write any empty formalism into the Constitution. Deeply embedded traditional ways of carrying out state policy, such as those of which petitioner complains, are often tougher and truer law than the dead words of the written text. So we are of opinion that such a discrimination, not invidious but long-sanctioned and indeed conventional, would not be offensive to the Fourteenth Amendment simply because Tennessee had reached it by a circuitous road. It is not the Fourteenth Amendment's function to uproot systems of taxation. Inseparable from the state's tradition of fiscal administration and ingrained in the habits of its people. . . .

"The argument basically derives from the fact that the Commission's valuation of petitioner's system was the same as that for the previous biennium, although numerous adverse economic factors are alleged to have greatly reduced the property's worth. But railroads, unlike farms and city lots and stocks and bonds, are not objects of exchange. The very notion of a 'full cash value' for a railroad is in many respects artificial. See 1 Bonbright, The Valuation of Property, pp. 511-632. Whatever may be the pretenses of exactitude in determining such a 'value,' to claim for it 'scientific' validity, is to employ the term in its loosest sense. (Citing cases) Thorough canvass by the state courts found no justification for upsetting the determination of the Commission, and we could scarcely find warrant in the record for doing so.

But even assuming that there was an over-assessment, constitutional invalidity would not follow.

"We conclude, therefore, that the Commission's over-assessment of petitioner's property, if over-assessment there was, constitutes no deprivation of any right under the Federal Constitution." *Nashville & C. Ry. v. Browning*, 310 U.S. 362, 368, 369, 370, 371, 60 S.Ct. 968, 84 L.Ed. 1254 (1939).

The most recent view of the United States Supreme Court on this subject is reflected in the dismissal of an appeal from the Supreme Court of Arizona for want of a substantial federal question in *Apache v. A.T.S.F. Ry. Co.*, 106 Ariz. 356, 476 P. 2d 657, 401 U.S. 1005, 28 L.Ed. 2d 542, 91 S.Ct. 1257.

The allegation was that the railway taxpayer was discriminated against because the Arizona legislature taxed some at 60%, some 40%, some 25%, and some 18% of value. The state Supreme Court upheld this classification, stating that groups specifically benefiting or specially burdening society may be required to pay additional taxes. It was held that placing all railroad companies in a class of property to be assessed at 60% of full cash value, while placing property of other taxpayers to be taxed at a less percentage of value did not violate constitutional provisions that all taxes be uniformly assessed on the same class of property. It was further held that this did not place an undue burden on interstate commerce.

In all of this litigation by utilities before the Kansas Supreme Court, the only one where the utility briefed and argued the constitutional question of burdening interstate commerce was in *Northern Natural Gas Company v. Bender*, now docketed as case #71-1104 and 71-1105. The Kansas Court held in syllabus #5 that the provisions of the state and federal constitutions were not violated "so long as all properties are assessed on the same basis, are measured by the

same yardstick and appropriate appeal provisions are provided for their review." (Appendix of 71-1105, A 285). In the body of the decisions the Kansas Court pointed the procedure to raise the question as to burden on interstate commerce, adding that the court was able to perceive no burden on interstate commerce.

UNIFORMITY

The really generalized definition of "value" that appears in the law books is that of Justice Holmes in *International Harvestor v. Kentucky,* 234 U.S. 216, 222, 34 S.Ct. 853, 58 L.Ed. 1284 (1913). He said:

> "Value is the effect in exchange of the relative social desire for compared objects expressed in terms of a common denominator."

There is the key: "expressed in terms of a common denominator."

We are here involved in a litigation as to a proper valuation for ad valorem tax purposes. We know the common denominator: "market value." How can this be applied to a public utility? How can it be so applied that it will be equal and uniform, not only between utilities, but with all other Kansas property owners who must be valued on the basis of market value? Have the rules of equality and uniformity, between utilities themselves, and between utilities and locally assessed taxpayers, been met? Those are the questions.

The second key is: *the results.* Has the objective been reached of "market value" in appellee's appraisal of appellant's property? If he has, and if he has followed generally those statutory valuation principles being used on other Kansas property owners which are applicable to utilities, he has at least approximated an acceptable degree of equality and uniformity.

Justice Butler spells it out this way:

> "The ascertainment of the value of a railway system is not a matter of arithmetical calculation and is not governed by any fixed and definite rule. Facts of great variety and number, exact and those that are approximations, forecasts based on probabilities and contingencies have bearing and properly may be taken into account to guide judgment in determining what is the money equivalent – the actual value – of the property." (Citing many cases) *Rowley v. Chicago & N. W. Ry.*, 293 U.S. 102, 109, 55 S.Ct. 55, 79 L.Ed. 222 (1933).

Cooley on Taxation, Vol. 1, Chap. 6, Sec. 299 expresses it this way:

> " . . . However, the generally accepted rule is that the uniformity required is uniformity in results and not uniformity in the methods of taxation. A uniformity method of valuation is not required but only that the regulations shall secure a just valuation of all the property taxed. The equality and uniformity rule does not require the same method of ascertaining the value of different property for the purpose of taxation. The property which is the subject of taxation is so various and different in its characteristics and conditions that a fixed and unvarying rule for ascertaining its value would be ineffective, and might easily produce a more unjust valuation than different methods and agencies created expressly for the purpose of adaption to the different classes of property sought to be valued."

CONCLUSIONS

1. If a part of petitioner's system is in operation within Kansas and augments the market or justifiable value of the system, even though it may be in use more than 29 years,

it is a real part of the "going concern" of petitioner's system and Kansas is entitled to count that part for ad valorem tax valuation purposes, F.P.C. designation as totally depreciated notwithstanding.

2. It is inaccurate to accuse respondents of *appraising* petitioner's property by adopting undepreciated original cost as the sole basis, when the record clearly shows that respondent's appraisal gave 40% weight to original cost and 40% weight to a reproduction new less depreciation approach and 20% to the income approach, and the appraisal figure was reduced to the level of original cost after a hearing.

3. The use of "rate base" or original cost less F.P.C. straight-line depreciation, as the sole criteria to be used in determining the justifiable or market value of petitioner's utility, would establish a fixed and unvarying rule for utilities in Kansas and would be an injustice to many Kansas taxpayers who could not enjoy the benefit of such a rule.

4. There exists reasonable, independent, adequate, nonfederal grounds to support the appraisal of petitioner's property in Kansas for 1971 ad valorem taxation, and for the judgments of the Kansas Board of Tax Appeals, the Kansas District Court and the Kansas Supreme Court in affirming that valuation and assessment thereunder.

5. It is respectfully submitted that the petition for writ of Certiorari be denied.

Respectfully submitted,

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APPENDIX

K.S.A. 79-503. Fair market value in money, how determined; factors; classification of property; forms; area meetings to develop guidelines. Fair market value in money shall mean the amount of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting, assuming that the parties thereto are acting without undue compulsion and that the property has been offered at the market place for a reasonable length of time. Sales in and of themselves shall not be the sole criteria of fair market value but shall be used in connection with cost, income and such other factors as may be appropriate including but not by way of exclusion:

(*a*) The proper classification of lands and improvements;

(*b*) the size thereof;

(*c*) the effect of location on value;

(*d*) depreciation, including physical deterioration or functional, economic or social obsolescence;

(*e*) cost of reproduction or improvements;

(*f*) productivity;

(*g*) earning capacity as indicated by lease price or by capitalization of net income;

(*h*) rental or reasonable rental values;

(*i*) sale value on open market with due allowance to abnormal inflationary factors influencing such values; and

(*j*) comparison with value of other property of known or recognized value. The ratio study shall not be used as an appraisal for appraisal purposes.

In each county of the state the county assessing officer shall

on January 1; 1971, and on January 1 of each year thereafter classify and subclassify all real estate into the following classes:

A. Urban property

1. *Residential.* Residential property shall include land and improvements thereon used or if unoccupied designed for use as a single family dwelling or home.

2. *Multifamily.* Multifamily property shall include land and improvements thereon containing independent dwelling units for two or more families in a single structure.

3. *Commercial.* Commercial property shall include land and improvements thereon concerned with all activities of business or trade engaged in for the purpose of producing income but shall not include industrial property.

4. *Industrial.* Industrial property shall include land and improvements thereon used for the conversion of materials into finished manufactured products or for the purpose of warehouses or minor processing plants.

5. *Vacant lots.* Vacant lots shall include unimproved property which has been platted into lots and blocks.

B. Rural property

1. *Agricultural investment.* Agricultural investment shall include those properties presently used and operated as units with a source of economic life from the production of agricultural products that originate from land productivity.

2. *Agricultural noninvestment.* Agricultural noninvestment shall include those properties presently used and operated as noneconomic agricultural units upon which some agricultural goods are produced but the primary source of value of which is as a rural home with cash needs derived from other than nonagricultural sources.

3. *Ho ae sites.* Home sites shall include those properties that provide residential uses only with rural atmosphère .that permits the use of horses, pets, etc. but do not produce goods or income from agricultural products.

4. *Planned subdivisions.* Planned subdivisions shall include those properties planned and platted for community residential uses, developed and sold as a commodity through wide mass sales exposure.

5. *Spot industrial and commercial.* Spot industrial and commercial properties shall include land and rural areas developed for spot industrial and commercial uses at selected locations to satisfy isolation or decentralized needs of industrial plants.

6. *Recreational.* Recreational properties shall include properties located in rural areas where lakes, streams, forest and mountain terrain and physical characteristics permit recreational uses of the commercial nature so that the source of economic life are from commercial improvements and not based on land capabilities and associated productivity responses.

The appraiser or assessor in arriving at fair market value in money may use different factors in determining the classifications best suited to arrive at fair market value in money as defined in this section. The director of property valuation shall as soon as possible prescribe forms for the county assessing officer of each county to assist them in making such classification and subclassification of property and to properly arrive at the fair market value in money of the property. To achieve greater uniformity in the appraisal of all real property, the director of property valuation is authorized and directed to meet with county assessors, appraisers, and interested property owners in area meetings embracing as many counties as the director deems advisable for the purpose of developing

regional guidelines to be used in the appraisal of all classes of real property. [L. 1963, ch. 460, § 4; L. 1965, ch. 515, § 1; L. 1969, ch. 433, § 10, July 1.]

K.S.A. 79-1436a. Same; classification of property by director; register of deeds to report classification of property sold. The director of property valuation in carrying out his duties under the assessment ratio study of real estate sales act (K.S.A. 1965 Supp. 79-1435 *et seq.*), is authorized and directed to provide for classification of properties which are sold, transferred or contracted to be sold or transferred. Real estate shall be classified as urban or rural property. Urban property shall be subclassified as residential, multifamily, commercial, industrial or vacant lot. Rural property shall be subclassified as agricultural investment, agricultural noninvestment, home sites, planned subdivisions, spot industrial and commercial and recreational. The director of property valuation shall require the register of deeds to show on forms provided therefor, the classification and subclassification, if any, of the property sold and the classification and subclassification, if any, after the transfer is effected. [L. 1967, ch. 489, § 3; L. 1969, ch. 435, § 1; July 1.]

K.S.A. 79-1436b. Same; deviation of classification of property; director to order reappraisal. In taxable years commencing after December 31, 1971, whenever the director of property valuation shall determine that the coefficient of deviation for any one classification or subclassification of property in a county, as shown from the ratio studies, is greater than 20, he is authorized and directed to order all property within the classification or subclassification within such county to be reappraised. [L. 1969, ch. 435, § 2; July 1.]